



# ***GLOBALISING YOUR PRACTICE - OPPORTUNITIES AND CHALLENGES***

## **Foreign direct investments The role of lawyers**

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# ***GLOBALISING YOUR PRACTICE - OPPORTUNITIES AND CHALLENGES***

## **Outline of Presentation**

- Direct vs. indirect investments
  - Capital markets
- Types of financing options
  - Equity investments
- Investors and their rights
  - Corporate control
  - Role of lawyers
- Tackling illegal conducts
  - Conclusions



# ***GLOBALISING YOUR PRACTICE - OPPORTUNITIES AND CHALLENGES***

## **Direct vs. Indirect Investments**

- **Direct investments: investor becomes owner.**
- **Indirect investments: investor becomes lender**

**Specific (as opposed to systemic) risks change:**

**Direct investment: business risk; depends on owners' business skills**

**Indirect investments: financial risk; depends on third party's performance**



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## **Capital Markets**

What is a capital market?

Part of the financial system concerned with raising long-term capital by trading securities and other long-term investments.

What is a security?

A tradeable financial instrument representing a claim; e.g shares or debt securities like bonds.

- If bonds (indirect investments): lender-borrower relationship.
- If shares (direct investments) ownership/management issues.

Types of capital markets:

- Primary market/New issue market – where securities are first issued and issuer receives funds – IPO, bond issuance
- Secondary market/After issue market – where previously issued securities trade between investors



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## **Securities in capital markets**

**Two main securities in the global capital markets:**

<b>Equity (shares)</b>	<b>Debt (bonds)</b>
Holder is owner	Holder is creditor
Voting and economic rights	Conversion rights
Dividends	Interest
Board control	Usually no voting rights
Residual value in liquidation	Rank higher than shares



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## **Why use capital markets?**

- Alternative source of financing (excludes bank-based lending)
- Better pricing, longer maturities and wider investor base
- Funding for riskier investments (not supported by banks)
- Exit route for certain investors such as venture capital and private equity funds
- Easy price discovery (listing and trading)
- Efficient allocation of capital across industries, and by extension, society as a whole.
- Wealth generation for savers and investors – attractive investment opportunities with better returns than banks can offer
- Risk diversification for investors



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## **Foreign indirect investments**

- **Challenges of raising funds domestically**
  - Capital requirements too big for domestic market
  - No local appetite to invest in equity
- **Why foreign capital?**
- Larger pool of capital and lower costs due to the potential segmentation and saturation of domestic markets
- Diversification of country risks and associated economic risks
- Potential to hedge foreign exchange risk
- Increased global recognition
- Tax reduction or avoidance
- Lower interest rates



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## **Where is capital raised?**

- **Market considerations**
  - Industry knowledge and best practices
  - Quality and enforcement of applicable law
  - Level of regulations
  - Financing structuring requirements eg accessing shariah financing
  - Market liquidity for firm securities
  - Pricing standards (international or domestic)





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## **Types of financing options**

### **Equity financing**

- Cross/dual listing
  - Issuing securities through subsidiaries in foreign markets
  - Global depository receipts
  - Euro-equity market
- 
- Debt financing
    - Foreign bank loans
    - Foreign bonds
    - Euromarket bonds



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## **Equity investments**

- **Partner/Shareholder:**

not a creditor; rather a (partial) owner of the company

- **Many domestic aspects to the transaction:**

Extent of partner/shareholder rights

(or how much power will investor enjoy?)

Nature of legal entity

Where are rights stated?

(statutes, bylaws, usage of trade, court precedents?)



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## **Different equity transactions:**

### **Private transactions**

- Stock purchase agreement (foreign investor acquires stock in an existing domestic corporation)
- Incorporation of a new domestic company (with foreign investor as an initial shareholder)

### **Public transactions (in listed companies):**

- Incorporation + Initial public offering
- Open market acquisitions
- Takeovers and mergers



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**Typical practical questions in all cases  
for lawyers to respond:**

- **How is money brought in?**
- **...and how does it leave?**
- **Are there controls and costs involved?**

**Tax implications at exit or on cash flows?**

- **Cross listing allowed? Implications?**

**(More to come!)**



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## **Incorporation of a new company**

- Are there different corporate types available?
- Are there particular benefits in the selection outcome?
- Do all types grant limited liability to partners/shareholders?
- Are they all similar as to tax consequences?

## **Acquiring stock in an existing entity**

- Which way to ensure against past contingencies?



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## **The investor**

- Who will be investing?
- Are all foreigners alike?
- Are all taxed alike?
- Is treaty protection/insurance available?
- Individuals or corporate entities?
- Need for registration of the investment
- Need for registration of the investor
- Is physical presence mandatory?



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Consequences of the different legal nature  
of equity transactions:

New shares to be issued

Existing shares to be bought

Which corporate activity required from issuer/seller?

- Limits?
- Types of shares
- Classes of stock



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## **Corporate control**

- How is control obtained and exercised?
- How can control be limited
  - By laws restrictions?
  - Shareholder agreements?
- Are there external control restrictions?
  - Antitrust legislation?
  - Public (state) participation?
- How to maintain control?





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## **Managerial issues**

- Directors (locals? expats?)
- Directors
- Directors standards
- Ultra activities
- Fees

**Auditors**

**Governance considerations**

***Compliance***



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## **Divestiture (Which way out?)**

- Tag along / Bring along (Piggy back)
- Put options
- Call options



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## **Tackling illegal conduct**

- **Lawyers play a role in preventing illegal conduct (IBA/OECD task force)**
  - ***“A lawyer must not act unethically or in any manner that condones, encourages or constitutes participation in illegal conduct”***
- ***“A lawyer is well placed not only to identify or detect illegal conduct, but also to facilitate it, by action or inaction, or prevent it”***



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Eight key principles:

- **Do not facilitate illegal conduct: undertake necessary due diligence.**
- **Do not misuse confidentiality to shield wrongdoers.**
- **Identify and verify client, ultimate beneficiary and origin of funds.**
- **Advise client of consequences and recommend alternative solutions.**
- **Verify possible existence of multijurisdictional risk.**
- **Discourage use of illegally obtained information.**
- **Obtain and maintain updated beneficial ownership information**
- **Transparent, accurate and truthful advertising**



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## **Illegal conducts**

- **Tax evasion**
- **Money laundering**
- **Terrorist financing**
- **Corruption**
- **Insider trading**
- **Evading international sanctions**



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## **Which professional role to the lawyers?**

- Document drafting
- Suggesting alternatives
- Legal representatives / agents?
- Can they act as directors? Or is this a conflict?
- Mere advisors?
- Are they counsel to the shareholders *and* to the company?



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## **Structuring a Deal**

- **Consider**
  - institutional and regulatory differences
  - different tax laws across countries
  - interest rates and other economic fundamentals
  - political risks, different market risks etc

**Corporate, financial and legal strategy should minimize cost of financing, maintain different types of risks within acceptable levels and seek seamless transaction**



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## **Market Requirements**

**In IPOs/ Private placements/ Bond issuances:**

- **Registration of securities and exemptions**
- **Best options/Modalities of raising money from global capital market**

**Costs of raising capital**

- **Regulatory and advisory fees**
- **Road shows**

**Interest coverage**





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## **Due Diligence**

- Statutory and exchange market requirements
- Other issues to consider:
  - Continuing obligations
  - Disclosures and level of disclosures
  - Investor expectations
  - Dividend/coupon payments
  - Transparent corporate strategy
  - Corporate governance
  - Financial reporting (auditing)
  - Prepare prospectus (business plan with detailed information about the company and the securities being issued)



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## **Disclosures and Investor Protection**

### **Policy rationale for disclosure**

- **Transparency (including both issuer and market transactions transparency)**
- **Market efficiency (in re securities pricing)**
- **Investor protection and confidence**
- **Good (corporate) governance**

### **Liability for –**

**Inadequate or defective disclosure, Deceit, Misrepresentation by action/omission**



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## **Conclusions**

**Companies have wide choice relating to capital raising, and investors have wide choice of investment alternatives**

- **What type of securities – equity or debt?**
- **Where to raise the capital – domestic or global markets?**
- **Direct or indirect investments?**

**Lawyers will always play a critical role in the entire process.  
But they must also watch over the legality of the transaction.**