



GLOBALISING YOUR PRACTICE - OPPORTUNITIES AND CHALLENGES

Foreign direct investments The role of lawyers

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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



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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:

Equity (shares)	Debt (bonds)
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**
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- **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.