

AFRICA

Kevin Abikoff of Hughes Hubbard Discusses the Benefits and Risks of African Local Content Laws

By Megan Zwiebel

Foreign investment in a country has historically been a double-edged sword. While investment may allow elites to prosper, often the benefits of investment do not flow to the general population. In response to this pattern, many countries have adopted “local content laws” that require a certain level of reinvestment by foreign companies into the countries where they operate.

These laws can require companies to build local infrastructure such as roads and schools. They can also require that the foreign company partner with local businesses or that local subsidiaries employ a certain number of people with particular racial or ethnic backgrounds. For example, South Africa’s Broad-Based Black Economic Empowerment program (BBBEE) gives preferential treatment to government tender offers made by companies that partner with local black-owned entities.

While these programs can have clear benefits in terms of technology transfer and local ownership, they can also be a source of corruption risk, as Japanese conglomerate Hitachi learned in 2015 when it was fined \$19 million for corruption related to its BBBEE partner. See “Lack of Training and Due Diligence Leads to \$19 Million Penalty for Hitachi” (Oct. 7, 2015).

The FCPA Report discussed navigating these programs when doing business in African countries, where they are prevalent, with Hughes Hubbard partner Kevin Abikoff. He explained why local content laws are beneficial but also how they can lead to corruption, and what companies can do to avoid problems when working with local partners.

Laws Designed, Theoretically, to Benefit Local Businesses

FCPAR: Why do many of the countries in Africa have local content laws?

Abikoff: These local content laws are aimed at the Africanization – or more accurately the Nigerianization,

Gabonization, or what have you – of businesses operating on the continent. African governments pass these laws in the hopes of transferring knowledge and resources from foreign corporations to local citizens. At a high level – politically, philosophically and intellectually – the notion that local people should participate in the economic benefit associated with development makes perfect sense. It speaks to fundamental issues of fairness to have some of the resources and benefits of development stay at home.

FCPAR: Who do African local content laws benefit?

Abikoff: At least nominally, the laws are aimed at getting the population in general involved with international commerce. However, the people who are in a position to own and manage assets are still at the upper strata of society which tend to be small communities in most countries. That means that the people involved in the local content programs tend to be related to, or close to, the ruling elite. There tends to be a small pool of people who have graduated from college and have the resources to participate in managing significant enterprises and that pool overlaps with the pool of people with the education and experience to be involved in government.

FCPAR: What challenges do local content laws present for foreign companies doing business in Africa?

Abikoff: While local content laws can be very beneficial to a country, they can be the single greatest cover for bad behavior. While Africa is not alone in this, it is certainly operating at a much deeper and higher level in terms of local content which creates unique risks for multinational companies operating there.

[See “Six Common FCPA Risks in Southern Africa and Strategies for Managing Those Risks” (Mar. 5, 2014).]

FCPAR: How do Africans usually view these local content laws?

Abikoff: The notion that there should be some local ownership

and local control over African land resources makes absolute sense from the African point of view. Foreign companies historically have come to Africa and exploited natural resources and left messes in their wake. However, despite locals theoretically agreeing with the laws, the history of abuse by multinational companies may mean that local partners take umbrage when a foreign company says it needs to apply extra-stringent controls to its local partners.

FCPAR: How can companies avoid causing such offense while still fulfilling their anti-corruption obligations under the FCPA and other legal regimes?

Abikoff: Having diligence programs and protocols that are facially neutral and apply the same sorts of tests to local partners as would be applied to multinational partners can help. Being able to say that all partners are treated alike can provide the company with some cover and ease tensions.

[See “How Can Companies Capture the Telecom, Energy and Resources Opportunities in Africa While Mitigating Corruption Risks?” (Oct. 9, 2013).]

Local Content Laws Come in Different Forms

FCPAR: What do local content laws generally look like in Africa?

Abikoff: They come in a few different varieties. Some mandate, at a legislative level, that local partners own a percentage of a particular business. Others specify that a percentage of the workforce has to be from the legislating country or part of a disadvantaged population within that country, like the BBBEE laws in South Africa. Still others require that certain positions within an entity be filled locally. Some specify a percentage of employees that must be of local origin. There are a lot of different flavors but the emphasis is the same.

FCPAR: Are there laws that focus less on who multinationals employ and more on how they invest?

Abikoff: Yes, there have always been first soft, and then hard, requirements that companies reinvest in the local infrastructure. Those types of laws were precursors to some of the local ownership and local participation rules.

FCPAR: Are there corruption risks associated with laws relating to local investments?

Abikoff: Yes, even those can be a double-edged sword.

example, imagine a foreign company builds a school or a water treatment plant. That is clearly a public benefit. However, if it is done around an election so that a local candidate can take the credit, the company may be facing an anti-corruption issue. Those types of issues happen frequently, even when the local investment is on a voluntary basis among companies just looking to do the right thing from a human rights perspective.

FCPAR: What happens if a foreign company does not comply with the local content laws?

Abikoff: In some countries companies can pay a fine and effectively opt-out of the local content requirements. However, the move is towards the non-opt-out types of regimes where a company can only do business in the African country if it complies with the law and takes on local partners. Considering the purpose of these laws is to help the local population, they shouldn't be something a company can buy its way out of.

[See “Regional Risk Spotlight: John Vincent Lonsberg of Baker Botts Helps Untangle the U.A.E.'s Web of Anti-Corruption Laws” (Oct. 21, 2015) (discussing U.A.E. local content offset requirements and opt-outs).]

Local Partners May Have Ties to Foreign Officials

FCPAR: What forms can corruption take in these local content programs?

Abikoff: To fulfill the local content requirements, foreign entities will often partner with a local company. One of the common complaints about local companies is the opaque ownership – it can be difficult to get accurate reporting on who owns what. This means it isn't always easy to determine whether government officials, their family members or close friends are part of the ownership of the local affiliate.

FCPAR: What can companies do to ensure that they are not unknowingly working with local partners that are partially owned by foreign officials?

Abikoff: Having an effective anti-corruption program always requires a multifaceted approach. To start, companies should perform some sort of reasonable due diligence to the extent possible. If it can, a company should also interview the owners of the possible partner face-to-face.

[See The FCPA Report's Conducting Effective Anti-Corruption

Due Diligence on Third Parties Interview Series: Gwen Romack, Director of Global Anti-Corruption at Hewlett-Packard (Oct. 9, 2013); Principals at Nardello & Co. (Sep. 26, 2013); and Alice Fisher, Partner at Latham & Watkins (Sep. 11, 2013).]

FCPAR: Are such face-to-face due diligence interviews common in Africa?

Abikoff: Some people say that there is cultural resistance to these types of interviews or that the local businesses might find them insulting. I haven't found that to be the case, typically. I've interviewed people in every dark corner of the globe and even if there is some initial resistance, it is not usually cultural. Usually, the issue is that somebody doesn't want to discuss certain things.

[See "Sample Questions to Ask Third Parties When Initiating Anti-Corruption Due Diligence" (Oct. 9, 2013).]

FCPAR: What other corruption issues can local content laws create?

Abikoff: Another issue that can come up is that the partner may have secured its participation as the local-content provider through promises or guarantees, directly or indirectly, to government officials. Essentially the local-content partner effectively becomes a conduit for corrupt payments to government officials.

Companies can also be tempted to make corrupt payments in order to ensure that they are able to work with their preferred local-content partner.

Bribes Can Be More Than Suitcases Full of Cash

FCPAR: Are the corrupt payments always monetary, or will other things of value be provided to government officials?

Abikoff: There is a move away from making monetary payments directly. I wouldn't say that the days of cash in a suitcase are gone because you still see the occasional case involving cash in a Louis Vuitton bag, but those types of direct payments are seen less and less. Banking regulations worldwide, particularly after September 11 and the PATRIOT Act in 2001, have limited people's willingness and ability to wander the globe with big sacks of cash.

FCPAR: What other types of things of value will be provided?

Abikoff: The methods by which corruption is executed is

limited only by the creativity of the human mind, which is not particularly limited. There are complex arrangements such as trading economic interests, secret shareholdings and guarantees.

[See "Hiring Practices and FCPA Compliance in the Wake of the BNY Settlement (Part One of Two)" (Jan. 13, 2016); Part Two (Jan. 27, 2016) (discussing the SEC's expanding definition of a "thing of value").]

Active Monitoring

FCPAR: Once a foreign company has entered into a relationship with a local partner, what can be done to prevent corruption?

Abikoff: It starts off by having an effective due diligence process which a company adheres to consistently. Unfortunately, it is possible for a local partner to fake its way through a due diligence process, so monitoring activities are critical. Accordingly, that monitoring needs to be more than just receiving activity reports. Somebody knowledgeable has to review those reports to make sure there are not issues. Companies should also secure audit rights in contracts and then actually conduct compliance and economic audits of the entity.

FCPAR: How feasible is it for companies to exercise their rights to audit their local content partners?

Abikoff: In my experience we have had success in exercising audit rights and I've conducted audits in some pretty complicated places. It is an exercise in persuasion and trust to find the proper middle ground. Typically, the sensitivity is because the local partner keeps fully-integrated books and records and doesn't want to give a foreign partner access to financial records for other clients or partners.

FCPAR: What are some of the strategies companies can use to get access to a local partner's books and records?

Abikoff: It's important to give the local partner notice so there is time to get people comfortable with the audit. Then, finding creative approaches to how the audit is conducted is often helpful. One of the methods we've used is to conduct the audit at arm's length. The foreign company will hire a forensic firm or a law firm to conduct the audit and report back so that the local partner doesn't have to share financial information about other clients with its partners.

In the extreme, the partners could also agree to pick a neutral third party that isn't chosen by the foreign company. That third party will independently review the books and records and then issue a report that gives a thumbs up or a thumbs down on whether there are indicators of corrupt practices. It's not as satisfying as the company itself performing the audit but it is a lot better than having the books and records of the third party be a complete black hole.

[See "When and How Should Companies Include Audit Rights in Third-Party Contracts? (Part One of Three)" (Jul. 23, 2014); Part Two (Aug. 6, 2014); and Part Three (Aug. 20, 2014).]

Training Local Partners Can Minimize Risk

FCPAR: Can companies use training to prevent corruption associated with their local content partners?

Abikoff: Training the local partner can be very effective. Many companies are shy about their compliance program. Companies will get certifications, reps and warranties and walk away relieved and quite proud of themselves. But the reality of it is that a certification is completely useless and possibly unenforceable if the person signing it doesn't know what it means. We have found people open and willing to participate in very detailed training and they often ask very interesting questions. Our experience shows that this can reduce the incidents of problematic conduct on the back end.

Especially when a company is dealing with a local content partner which, almost by definition, means that it will be working with people with little experience with international anti-corruption requirements, you owe it to them to not just hand them policies that may never be read, but also give actual in-person training. Companies should be bold enough to presume that their local partners are going to do the right thing if they know what the rules are.

[See "Twenty Tips for Creating an Effective Training Program" (Oct. 8, 2014).]