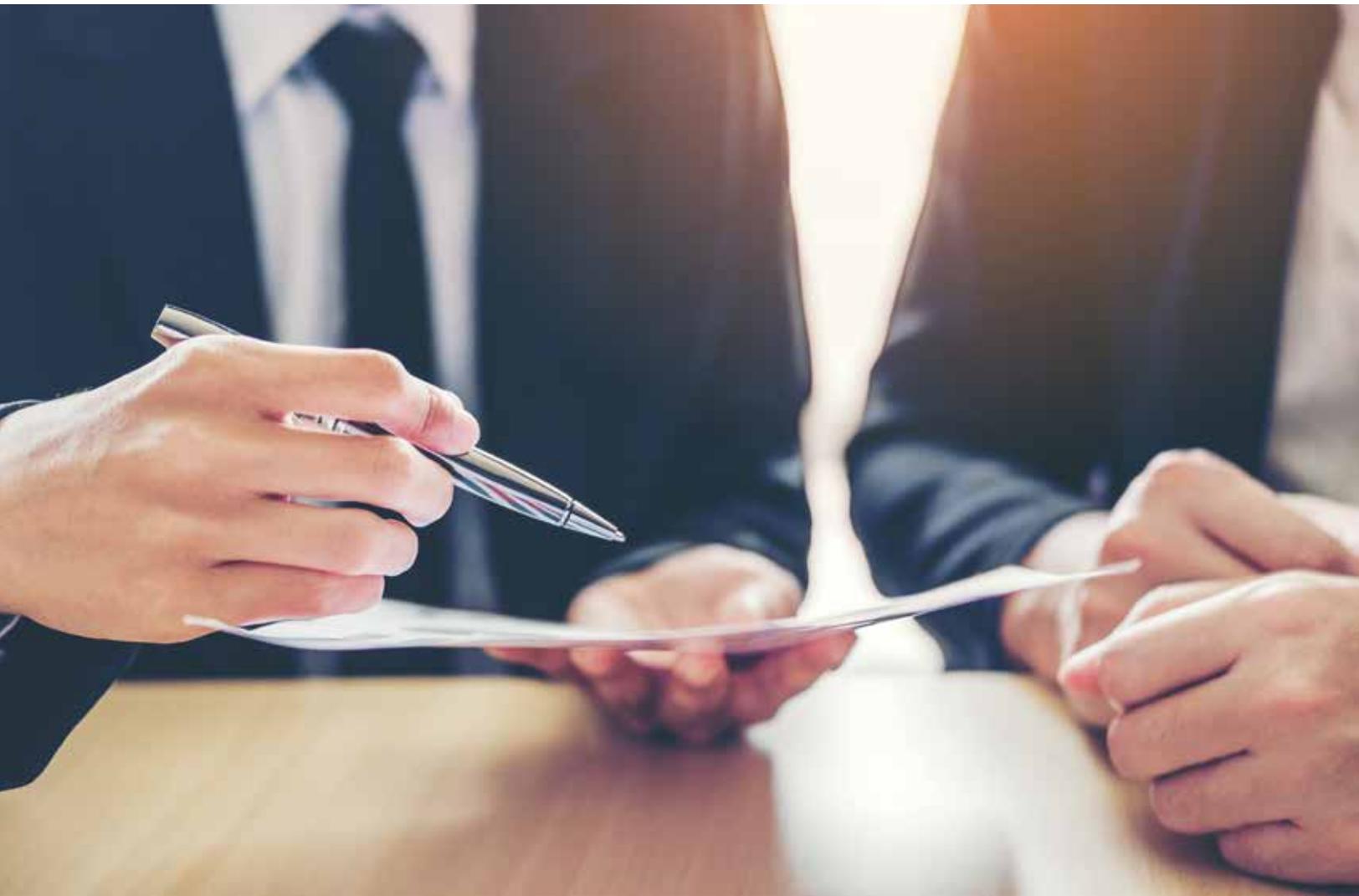




Cross-Border Impact Investments

A Legal Primer For Families, with NYU Law School



The ImPact is a membership network of family enterprises (family offices, foundations, and businesses) that are committed to making investments with measurable social impact. The ImPact provides families with the knowledge and network they need to make more impact investments more effectively, and uses sophisticated technology for data aggregation, analysis, and reporting to shift the narrative of impact investing from one of inputs (dollars committed) to outcomes (impact created). Our purpose is to improve the probability and pace of solving social problems by increasing the flow of capital to investments generating measurable social impact.



CROSS-BORDER IMPACT INVESTMENTS

A LEGAL PRIMER FOR FAMILIES

Many of The ImPact's member families are inspired by the opportunity to invest for impact in emerging markets. Investments in these markets have extraordinary potential to create social and environmental impact. These opportunities also present new and sometimes complex legal considerations. The goal of this primer is to provide families with a summary of the important issues and an outline of the key questions to ask their local and international counsel¹ when making international impact investments.

This primer contains two parts: Part one explores the critical role that local counsel plays in appropriately assessing, structuring, and managing investments. It also explains how an understanding of local legal systems and cultures can facilitate better managed transactions. Part two of the primer outlines the questions families should discuss with their local counsel before entering into an international investment agreement.

By no means does this primer exhaust all the potential legal issues that may arise within cross-border impact investments. Rather, it is intended to be a tool for families to use as they conduct their due diligence and engage local legal counsel.²

This primer is the product of a partnership between The ImPact and New York University Law School's International Transactions Clinic. The authors of this primer are Monica Hernandez and Claire Bang, advised by Professor Deborah Burand.

Analyzing Local Legal Systems and Cultures

While the general characteristics of impact investments are consistent across borders, any cross-border transaction may raise legal, regulatory, tax, and accounting issues that can vary greatly depending on the jurisdiction where the investment is being made. The structure and documentation of an investment in one jurisdiction may differ from the way the deal would be done in the investor's home jurisdiction. Care must be taken to understand the risks and customs in the local market in order to understand the best means to structure a cross-border impact investment.

Being mindful of local law and customs can help the impact investor build a relationship with the local investee as well as help the investor to manage expectations when negotiating the deal documents or exercising or enforcing rights. Investor

sensitivity to local practices and the local legal regime supports constructive negotiations with local counterparties, increases the likelihood that investors will propose deal structures that are comprehensible from a local law and practice point of view, and avoids ambiguities that may lead to frustrated expectations, failed deals, and future disputes. Familiarity with the local legal culture is essential to ensuring that investors make informed decisions with regards to implementation of investments. Understanding local legal culture can help the investor determine whether the deal documents are enforceable; how to achieve industry or sector regulatory compliance; what governing law and dispute resolution mechanisms to select; how the relevant tax laws, currency or foreign investment restrictions, and other similar regimes will impact the structure and economics of the deal; and other related matters.



Care must be taken to understand the risks and customs in the local market in order to understand the best means to structure a cross-border impact investment.



Due to the unique considerations applicable to cross-border impact investing, investors should engage local counsel to help them understand the issues and avoid potential pitfalls.

Legal provisions and customs applicable to USA transactions do not necessarily have the same meaning, or may not be permissible, in other jurisdictions. It is important, therefore, for an investor to understand when it is best to use legal documents based on local precedents, and what risks may be created if an investor decides to use legal documents based on USA or international precedents. For example, in some jurisdictions standard agreements may be briefer and rely on the backdrop of code provisions to fill in “gaps” that in USA practice would be included in the specific agreement documents. The risk of using USA precedent documents in such a case would be that judges, government bodies, and other actors are not familiar with such extensive documents, making the use of such extensive documents potentially counterproductive. Due to the unique considerations applicable to cross-border impact investing, investors should engage local counsel to help them understand these issues and avoid potential pitfalls.

An investor will want to consider the political and economic culture of the investee’s country and how receptive the country’s culture is to foreign investment. While not necessarily something to ask of local counsel, it is still an important element of the larger due diligence process. An investor should also understand the potential geopolitical risks involved with investing in a specific country or region. Political or economic strife may potentially affect the deal value or pose obstacles for the investor when looking to legally enforce the deal documents. An investor may want to research past or present examples of foreign investors being disproportionately impacted by an economic or political crisis. For example, does the country have a history of expropriating foreign property or

not paying foreign debt in times of crisis? In certain cases, financial products can be purchased to mitigate some of these risks. For instance, an investor may consider procuring political risk insurance, which provides protection against a variety of political risks beyond an investor’s control, such as war, politically motivated violence, expropriation, and inconvertibility of currency. However, not all countries are covered by political risk insurance. Alternatively, deal structures may be created to respond to these perceived risks, such as procuring a third-party guarantor not located within the local country or letter of credit from an external bank.

Analyzing a host country’s legal system and culture in the context of impact investing can be challenging since impact investing is a relatively new field and investors are still experimenting with various investment approaches and mechanisms. Impact investors that use special legal forms, contractual provisions, or business terms to “bake in” or protect the social mission of a company through its life cycle should note the legal enforceability of these forms, provisions, and terms has not been tested to date. Other self-identifying impact investors take a very commercial approach to how they structure their impact investments and the contractual terms of those investments, so there may be few, if any, special considerations when making an impact investment relative to conventional forms of cross-border investment.³

Engaging Local Counsel

Local counsel should be engaged relatively early in the investment process to ensure that the transaction is properly structured and enforceable under local law. Investors engage local counsel at different points in the investment process. Local counsel may be engaged before deal documents are negotiated or drafted; after preliminary negotiations are conducted and a term sheet is drafted; or after all the deal documents are finalized, but not yet

signed. There are pros and cons to engaging counsel at each point. For example, engaging local counsel only after the deal documents are completely negotiated and drafted may streamline the questions to be asked of counsel since the specifics of the deal are fully known. However, the risk of waiting to consult local counsel is that a fundamental aspect of the deal may be unenforceable in the local country such that the deal has to be fundamentally renegotiated and redrafted, thus imposing additional, unwanted time and costs to the investment.

While using local counsel requires an upfront financial commitment, the benefits of engaging local counsel usually outweigh the cost. Engaging local counsel early in the investment process can minimize unnecessary additional costs and time spent restructuring a transaction to ensure compliance with local regulations. Improperly structured transactions can result in unforeseen taxes or other costs not considered when the investor initially agreed to make the investment. Further, local counsel can provide essential insight into the legal culture of the local jurisdiction and identify potential roadblocks and legal issues before they become problems.

Managing the involvement of lawyers and legal costs is a chronic challenge globally, and it is particularly acute for those making investments in emerging markets. Impact investors commonly face two challenges when looking to engage local counsel: (1) many impact investments are relatively small in size, thus the transaction costs of engaging local counsel can overwhelm the size of the deal (*pro bono* legal services and legal services provided at reduced rate are not as common in all countries as they are in the United States); and (2) impact investing is still a relatively nascent sector, thus investors may find it difficult to find local counsel that has encountered the unique deal structures and contractual provisions that could potentially be used to

conduct an impact investment. A variety of organizations are taking steps to identify and, in some cases, train qualified local counsel in emerging market jurisdictions⁴, but more work needs to be done.

Below is a discussion of key issues that are likely to arise in the context of cross-border impact investing. Investors should consider discussing these issues with local counsel, as many are issues on which local counsel can provide insight. Specific questions to consider asking local counsel with respect to each of the following topics are listed in the attached Local Counsel Checklist. Of course, the specific questions to ask local counsel will vary significantly depending on the facts or circumstances of a deal. A prior discussion with an international counsel regarding what questions should be asked to the local counsel in their particular deal may help the investors to engage local counsel in an even more effective manner.

Restrictions on Foreign Investments

Local counsel can help an investor understand the restrictions a country may place on foreign investments. For example, a country may restrict the amount of money a foreign entity can invest locally or the percentage of ownership a foreign investor can own of a local entity. The local legal regime may have sector specific regulatory restrictions that prohibit or limit the percentage of ownership a foreigner may have in an entity operating in one or more sectors, or restrictions may depend on the structure of the investment, such as whether the investor is investing directly or indirectly into the local entity. Further, as a matter of law or as a matter of practice, the local country may refuse to extend rights or protections to a foreign investor that may be afforded to local investors.



Investors should not assume that USA or English law are always the best choice to govern deal documents; sometimes it is in the best interest of the investor to have the deal documents governed by local law.

Complying with Local Rules and Regulations⁵

Compliance with a host government's rules and regulations can be complex and will be particular to the specific country. Asking local counsel questions relating to regulatory compliance is essential because failure to comply with local rules and regulations could result in fines, penalties, invalidity of documents or transactions, criminal liability, or impede the investor's ability to enforce its rights under the deal documents, such that the expected and bargained-for economic returns are potentially unachievable.

Local rules and regulations can span a broad spectrum of issues. Specifically, local regulations may require investors to verify the identity of the investees and ensure that they are not financing terrorism or persons engaged in money-laundering activities.⁶ Additionally, local counsel can also guide investors in determining whether they are required to file or register with the local government before executing a loan or equity purchase agreement or otherwise during the course of the investment process.

Ensuring Your Deal Documents Are Enforceable and Choosing Dispute Resolution Mechanism

Investors cannot assume that the execution of the deal documents means that the deal documentation and specific provisions within such documentation will be automatically enforceable under local law as investors intend them to be. Unique enforceability questions can arise with impact investments in which contractual provisions are used to ensure compliance with social missions or the achievement of desired social impacts. In some jurisdictions, for example, impact investors may

find that they hold unenforceable claims such as covenants requiring investees to comply with certain specified social missions, or providing investors with redemption rights should an investee fail to meet certain social impact metrics. Accordingly, investors will want to consult with local counsel to ensure that they structure their deals and execute the correct documents in the proper form as to affirm that the local jurisdiction will give effect to the provisions of the deal documents and protect the investors' interests.

Investors can engage local counsel to determine under which law the deal documents should be governed and by what means any potential disputes should be resolved. Investors should not assume that USA or English law are always the best choice to govern deal documents; sometimes it is in the best interest of the investor to have the deal documents governed by local law. Local counsel also can explain how the local legal system will deal with a dispute and the best means of dispute resolution as well as the risks and challenges of alternative options. If the local counsel informs a foreign investor that the local court system is particularly slow, costly, or partial to local entities, or that local laws as applied or drafted are unpredictable or unfriendly to foreign investors, the investor may want to consider whether it is advisable to select another jurisdiction's law to govern the deal documents. Understanding how friendly the local legal system is to foreign investors will likely influence an investor's choice of dispute resolution.

Such information also may help the investor consider opting to have parties submit to the courts of another jurisdiction or international arbitration to resolve disputes. The effectiveness of choosing another jurisdiction's law or an alternative dispute resolution will turn in part, however, on whether local authorities

can be expected to recognize and give effect to, as a legal and practical matter, deal documents and rights governed by foreign law, or decisions and remedies ordered by a foreign court or tribunal. Specifically, in the impact investment context, an impact investor will want to consider how the governing law and dispute resolution mechanism are likely to shape and respond to the resolution of disputes arising out of the social impact goals of the deal. This consideration also should look at the costs of resorting to such law and dispute mechanism relative to the size of the investment that may be in dispute. The investor may want to consider choosing a governing law and dispute resolution mechanism that, as practical matter, are able to efficiently govern, adjudicate, and enforce such disputes relating to impact-specific provisions of the deal documents. Getting both legal and practical, experience-based feedback can assist the investor in understanding the risk and benefits of different governing law and dispute resolution alternatives.

When Money Flows Across Borders

A host of issues can arise when money flows across borders ranging from particular restrictions the local government places on foreign investments to an investor's exposure to other foreign exchange/currency risks. These risks fall into two broad categories: when money is "flowing into" the local jurisdiction, i.e. when the investor is investing money, and when money is "flowing out" of the local jurisdiction, i.e. when the investor is repatriating its investment and profits or earnings thereon. Legal considerations that may arise when investing money into the local jurisdiction range from local regulations requiring foreign investors to register their foreign investment, to the local jurisdiction placing taxes on a foreign investment. Complying with local regulations may be required in order for the investor to successfully repatriate its investment when

the time comes. Particularly in the context of equity investments, an investor will want to structure the deal in a way that provides the best exit options by considering, for example, what liquidity events permit an investor to exit and whether the exit will occur through a sale at the local operating level or through a sale of an offshore structure.

Local and international counsel can provide advice on deal structures that mitigate, minimize, or even avoid foreign exchange risks. Certain impact investors who prioritize social impact over financial return may be more willing to lend in local currency, even in markets where currency risk is relatively higher, thus assuming some degree of the foreign exchange risk within the transaction. Deal structures can help address some of these foreign exchange risks, as can some financial products (such as foreign exchange hedging instruments or inconvertibility insurance). A challenge for some impact investors, however, is that buying a hedge or insurance may be impractical given the relatively small size of the investment or exotic nature of the local currency where the investment is being made. Local counsel, based on their knowledge of local regulations, may be able to assist the investor with certain local exchange risk issues; however, an investor also should consider consulting with financial experts in the field.

Tax Planning

Investors based in the United States will want to ensure that they understand not only the local taxation regime but also how the local taxation regime interacts with the USA taxation regime or the tax regime applicable to the investment vehicle that may be used to make the investment. While local counsel can be leveraged to assist in this inquiry, local tax advisors



Complying with local regulations may be required in order for the investor to successfully repatriate its investment when the time comes.



Consulting local counsel early in the investment process can be a vital step to ensuring that an investor's cross-border impact investment is structured efficiently and effectively.

or cross-border tax experts will also be essential players in understanding the local tax regime and the international offshore tax regime to which USA investors are subjected.

Investors will want to avoid negative consequences, and potentially will need to structure their cross-border transaction so as to avoid being subjected to taxation by multiple jurisdictions on the same income. Many countries have punitive tax provisions applicable to any investments made through vehicles that the jurisdiction deems a “tax haven.” Depending on the jurisdiction of the investee, the investor may be subject to withholding tax requirements on amounts it is to receive, such as interest payments. Investors may structure the transaction to minimize withholding taxes, and in some cases an investor may be able to apply for an exemption or status that minimizes withholding taxes. However, generally transactions allocate responsibility for paying withholding taxes on interest or other similar payments to the investee through so-called “gross-up provisions” (even though the tax liability for the tax may be that of the investor), thus increasing the cost of the financing to the investee. Other examples of taxes that can be triggered by an investment include stamp taxes that apply when documents are executed, taxes on financial transactions, or taxes on dividend repatriations.

Conclusion

Consulting local counsel early in the investment process can be a vital step to ensuring that an investor's cross-border impact investment is structured efficiently and effectively. The following local counsel checklist is a tool for an investor looking to engage local counsel in cross-border impact investments.

The checklist is intended to cover, at a high-level, questions and considerations that an impact investor may want to consider discussing with local counsel. This checklist is not an exhaustive list of questions or issues. Some impact investors may need to expand the questions asked of local counsel to ensure that their approaches are advisable and enforceable in the jurisdictions where their impact investments are taking place. For example, as noted above, local counsel may be very useful in determining the enforceability of provisions that allow an investor to demand loan repayment or redemption of its equity investment if the investee deviates from the social mission. Local counsel also can help investors understand what alternative investment forms are available, and whether the local law recognizes special forms of legal entities akin to “benefit corporations or “L3Cs” that expressly authorize the boards of such entities to seek or take into consideration social impacts in addition to financial returns. On the other hand, some of the questions and considerations listed in the checklist may not be applicable. Accordingly, an impact investor may find it useful (and efficient) to engage international counsel to help determine which questions and considerations contained in the local counsel checklist are most applicable to the facts and circumstance of a specific deal.

LOCAL COUNSEL CHECKLIST

DEBT AND EQUITY CROSS-BORDER IMPACT INVESTING

The following are topics and questions that an Investor may want to consider exploring with and asking of local counsel especially when entering into a market for the first time. Of course, the applicability of these questions will need to be tailored to the nature of the potential investment and the Investee.

Definition Section⁷:

Borrower: a person or entity organized under or existing under the laws of a country other than the United States that has received a loan or other debt investment from a Lender.

Equity Investor: a United States person or form of entity that invests money in a foreign company in exchange for an equity interest in the foreign company.

Investor: both the Equity Investor and Lender, collectively.

Issuer: a company organized under or existing under the laws of a country other than the United States that issues and sells an equity interest to an Equity Investor.

Lender: a United States person or entity that makes a loan or other debt investment available to a Borrower.

Investee: both Issuer and a Borrower, collectively.

Restrictions on Foreign Investments

Are Investors prohibited from investing (or is express governmental approval required to invest) in certain sectors of the economy, specific activities, or industries e.g. renewable energy, healthcare, infrastructure, shipping or air transportation, journalism, or banking?

Does the local government impose restrictions on the amount of foreign investment that can be invested into different sectors and industries?

Are foreign investments subjected to varying restrictions depending on whether the Investor is directly investing or indirectly investing via a third party intermediary or investment vehicle?

Is the protection of an investment treaty or a tax treaty available to the Investor?

Are Investors required to waive investment protections extended by their own government to invest in the foreign country?

Questions Specific to Equity Financing

- Are there regulations that limit an Equity Investor's right to be paid dividends or other distributions, or limit an Equity Investor's redemption rights?
- Does the local government place limitations on foreign ownership of a local company, such as limiting the percentage of equity an Equity Investor can own of a local company?
- Does the local law require there to be a local equity holder in the company?
- Are there certain types of assets that a foreign controlled entity is barred from owning?
- Are there minimum capitalization requirements?

Questions Specific to Debt Financing

- Does the local government restrict the amount of a loan that can be invested into local companies and originate offshore, or require the loan to be invested in a specific currency?
- Does the local government impose restrictions or other forms of currency controls on capital flows (repayments) of short-term loans?
- Can a Lender charge interest? Can a Lender charge default interest?
- Are there usury laws? If so, what interest rates are considered usurious?

□ Compliance—Knowing the Investee

What kind of entity is the target Investee? Who are the existing equity holders?

Is the Investee a regulated entity? If so, how and by what institution?

Does the Investee validly exist, and is it in good standing, under the laws of the Investee's country?

Does the Investee have the power to execute, deliver, and perform the transaction with the Investor?

Do local regulators require Investors to adhere to Anti-Money-Laundering ("AML") and Combating the Financing of Terrorism ("CFT") standards?

- Is it sufficient for an Investor to meet the USA standards or does local law have additional or supplementary requirements, and if so, what are the local rules?
- Are Investors required to demand an Anti-Corruption CEO Certificate⁸ from the Investee under local law?

Does failure to comply with the AML, CFT, or other anti-corruption/anti-terrorism regulations prohibit Investors from enforcing their rights under their respective deal documents under local law?

Does failure to comply the AML, CFT, or other anti-corruption/anti-terrorism regulations subject the Investor to fines, penalties, criminal liability, or revocation of investment rights under local law?

□ Compliance—Local Filing and Registration Regulations

Are Investors required to register, obtain a license, or pursue other procedures in order to invest in the target company?

If the target company is a regulated entity, how, if at all, does it impact applicable documents, filings, or other requirements?

Questions Specific to Equity Financing

- Does the local jurisdiction require the Equity Investor to comply with filing or registration requirements before it can:
 - Buy equity of an Issuer in the local jurisdiction; or
 - Transfer equity in a local company?

Questions Specific to Debt Financing

- Does the local jurisdiction require the Lender to comply with filing or registration requirements before it can:
 - Make a loan in the local jurisdiction;
 - Take a security interest in the Borrower's assets;
 - Enforce a loan in the Borrower's jurisdiction if there is a default under the loan agreement; or
 - Foreclose on collateral?

□ Carrying out Business in the Country

Do Investors need to be licensed, qualified, or entitled to carry on business in the Investee's country in order to execute, deliver, or perform a loan/equity investment, or exercise their rights under their respective deal documents?

Is an Investor considered a resident, domiciled, or carrying out business by reason only of the execution, delivery, performance, or enforcement of a loan/equity investment?

- If so, will the Investors be subjected to additional regulations, fees, or requirements?

Do Investors need approval of a banking authority, regulatory institution, or governmental department in order to invest in the local country?

□ Enforceability—Executing Valid and Enforceable Deal Document

Are there procedural requirements with which an Investor must comply in order to authorize the execution, delivery, and performance of debt/equity documents, and to make such deal documents valid and enforceable?

- Do deal documents need to be in the language of the host country? If so, do they need to be translated by a certified or registered translator?
- Do deal documents need to be registered or recorded with a governmental, administrative or other authority or court in the Investee's country?
- Do deal documents need to be notarized, registered, or stamped?
- Do deal documents need to be in a particular form?

Are there substantive requirements with which the Investor must comply in order to authorize the execution, delivery, and performance of debt/equity documents, and to make such deal documents valid and enforceable?

- Are there certain provisions or terms that must be included in the deal documents?
- Are there certain documents that are not recognized by local government and/or local courts and not actionable under local law?

Are certain deal provisions not enforceable, either by law or practice?

- Does local law enforce negative covenants, such as:
 - Restrictions on the ability of the Investee to make payments outside of dividends to shareholders, repayments on a loan, or payments in the ordinary course of the Investee's business?
 - Restrictions on the ability of the Investee to incur liabilities?
 - Restrictions on the ability of the Investee to dispose of all or a substantial amount of its material assets?
 - Restrictions on the ability of the Investee to make investments or acquisitions outside its ordinary course of business?

- Questions Specific to Equity

Are provisions placing restrictions on the transferability of equity interests enforceable?

Are provisions requiring the Issuer to maintain minimum capital contributions enforceable?

What rights do minority Equity Investors enjoy as a matter of law (as opposed to as a matter of contract)? What rights may minority Equity Investors not have?

- Questions Specific to Debt

Are mandatory prepayment and acceleration provisions enforceable?

Is a contractual provision imposing a late fee (default interest) upon the Borrower enforceable?

Are provisions restricting the ability of the Borrower to issue additional debt enforceable?

Is local court (or regulatory) approval required in order to restructure any terms of the debt?

Enforceability—Governing Law Clauses

As a matter of law, are documents that are governed by a foreign jurisdiction (assuming the deal documents are valid, binding and enforceable under such foreign law) valid and enforceable in the Investee's jurisdiction? If not, will the local court simply apply local law?

As a matter of practice, have past Investors or others with experience in cross-border impact investing found the local government and/or judiciary to more readily recognize and enforce deal documents governed by local laws?

As a matter of practice, do Investors generally elect the laws of a particular foreign jurisdiction to govern the documents for cross-border investments?

□ Enforceability—Forum Selection

From Investors or others familiar with cross-border impact investing past experience, how long and how costly is the process of bringing a lawsuit in the local judiciary?

What is the common perception of the efficiency, independence, and quality of the judiciary at relevant levels?

- Is it possible or likely that the local government might interfere in local judicial proceedings in favor of its citizens?
- Have other foreign Investors looking to resolve disputes or enforce rights found that they have received impartial judgments from the local judiciary?
- Do Investees' or their property have the benefit of any immunity from the jurisdiction of any court or from any legal process, whether through service or notice, attachment prior to judgment, attachment in aid of execution, execution, or otherwise, under the law of the Investee's country?

Are there any restrictions on foreigners using local courts?

Do lawsuits regarding foreign equity/debt investments and/or commercial disputes have to be brought in a special local court, e.g. commercial court?

As a matter of law and practice, are provisions in a deal document that subject an Investee to the exclusive or non-exclusive jurisdiction of a foreign judiciary or arbitration valid, effective, and enforceable?

- Is submission to a foreign jurisdiction irrevocably binding on the Investee?

As a matter of law and practice, are provisions that submit parties to arbitration enforceable?

- Does local law impose any restrictions on choices of arbitration forum or procedure, e.g. local arbitration forums versus international arbitration forums?
- Does the country have a history of recognizing and enforcing judgments of certain arbitration tribunals more than others? If so, which tribunal's judgments are generally enforced?
- What are the local arbitration forums, if any, that local counsel recommends and have gained a reputation of efficiency and impartiality?

Are there other commonly used forms of alternative dispute resolutions in foreign investment agreements, e.g., mediation or conciliation?

□ Enforceability—Enforcing Judgments

As a matter of law and practice, have foreign Investors that have received judgments from a foreign judiciary or arbitration forum found those foreign judgments enforceable against the Investee in the appropriate courts of the Investee's country?

In order to enforce a foreign judgment, does the Investor have to follow certain requirements of civil procedure law of the Investee's country?

□ Issues Related to Money Flowing Across Borders—Money Flowing “In”

Do foreign Investors have to register their investment with local governmental or administrative agency in order to repatriate their investment in the future?

Can an Investor make disbursements to the Investee in USA Dollars or must it be disbursed in local currency?

Are there legal/regulatory limitations on a loan or equity investment denominated in foreign (not local) currency?

□ Issues Related to Money Flowing Across Borders—Money Flowing “Out”

Can an Investee pay dividends, interest, loan repayments, or other payments in USA Dollars (non-local currency), or do payments have to be made in local currency?

What deal structures, if any, are foreign Investors using to mitigate, minimize, or avoid foreign exchange risk?

What priority are obligations to foreign Investors given relative to local Investee’s other financial obligations?

What are creditor’s rights in bankruptcy?

- Do the bankruptcy and insolvency laws in the Investee’s jurisdiction provide for any moratorium or standstill period before the Investor can exercise its rights against the Investee’s assets?
- As a matter of law and practice, is there an order of distribution of the Investee’s assets to the Investor/creditor?
- Does local law permit the local company to restructure outside of court or outside the formal procedures of the local jurisdiction?

Questions Specific to Equity Financing

- Are there restrictions on an Equity Investor’s right of redemption or right to sell assets?
- What exit options are permissible as a matter of law, or what types of liquidation events are common as a matter of practice? For example initial public offerings or private sale of shares.
- Are there structures commonly used to assist foreign investors to divest equity interests, such as the use of an offshore vehicle?

Questions Specific to Debt Financing

- Are there restrictions on a Lender’s right to get repayment of its loan?

□ Tax Planning

Is there any tax, levy, impost, deduction, charge, or withholding by the Investee's country or any political subdivision or taxing authority thereof or therein either:

- (a) On or by virtue of the execution or delivery of the debt or equity agreement or any other document furnished thereunder; or
- (b) On any payment to be made by the Investee pursuant to the debt or equity agreement?

Are there unusual tax issues or complexities that are likely to apply to foreign investments or to Borrowers/Issuers receiving offshore funding?

- Is there tax haven legislation that creates disincentives or imposes penalties depending on where investments originate or where counterparties are organized?

From a tax point of view, is it more beneficial for the Investor to invest directly into the Investee or to invest indirectly via a local or international intermediary?

From what offshore jurisdiction do foreign Investors typically invest, e.g. Mauritius, Channel Island, Cyprus, BVI, etc.? What are the advantages?

What taxes, if any, are applicable to fees? Would tax regulators ever characterize fees as disguised interest?

Are there relevant tax treaties, e.g. double taxation agreement or Income Tax Treaty, between the United States and the Investee's country?

Questions Specific to Equity Financing

- What are the tax consequences to the Equity Investors on the dividends that are paid out to them?

Questions Specific to Debt Financing

- What is the applicable tax convention between the United States and the foreign jurisdiction concerning applicable withholding rates on interest payments made across borders?
- Are there "thin capitalization" rules that would limit how much of the interest paid on debt is deductible by the Borrower? If so, how are they applied?
- If there is a withholding tax on interest or other payments, is a reduction in the applicable withholding tax rate available due to a tax treaty, or if a Lender registers or otherwise applies for a reduction locally?

□ Miscellaneous Restrictions—Specific to Equity Financing

What types of shareholder rights do Equity Investors typically hold in the local jurisdiction?

- What are, if any, the minority rights available to Equity Investors as a matter of law (as opposed to contract)?

Are there restrictions or requirements on an Equity Investor's right to:

- Occupy a board seat of the target company; or
What are the costs associated with holding a board seat?
- Vote on board resolutions?

Are Equity Investors' rights executed in a shareholder's agreement, or do such rights have to be included in the by-laws or other constitutive documents of the Issuer?

What constitutes foreign control of a company (voting, ownership, indirect control, etc.), and are there any additional restrictions, requirements, or fees placed on a company under foreign control?

□ **Miscellaneous Restrictions—Specific to Debt Financing**

Guarantees

- Does local law permit or limit the use of a third party guarantor?
- Is the local practice to have a guarantor execute a separate guaranty document or simply execute the loan or credit agreement using specific language at the signature line?
- Are there particular structures for guarantees under local law that require specific documents to be used or language to be inserted?
- Do guarantors have the benefit of legal protections that might cause recourse under a guarantee to be unavailable under certain circumstances? For instance, must a Lender first sue or exhaust remedies against the Borrower prior to being able to avail itself of the guarantees?

Secured Loans:

- If the Lender proposes to obtain collateral security interest or liens on assets for a Borrower or guarantor, what types of assets are contemplated as security?
- How can debt obligations in the particular transaction be secured under local law?
 - What is the procedure to perfect a security interest on the relevant assets? How does the procedure differ for real property, inventory, accounts receivable, intellectual property, or other tangible or intangible assets?
 - How can the Lender find out whether the intended assets are already subject to security interest or liens in favor of other lenders?
 - Does a Lender need a local trustee or agent in order to hold the security?
 - How expensive is the process to create, perfect, and hold a security interest?
 - How expensive or cumbersome is it to enforce collateral security interests or liens?
 - Does the foreign government limit the Lender's ability to secure his/her loan with security interest or liens?
- Are there limits on the Lender's ability to take possession of and sell the collateral?
 - Practically speaking, is foreclosure on pledged assets feasible?
 - Can the title to the asset be transferred to the Lender or its agent?

□ Impact Investing Issues

Would local courts enforce contractual provisions that permit Investors to force a repayment/redemption of the investment if social mission targets are missed or deviated from?

Does local law recognize specific forms of legal entities as “social enterprises” or companies that are required/permitted to seek social impact as well as financial returns, e.g., forms that are akin to the “benefit corporation,” “L3C,” “flexible purpose corporation,” “community interest company,” etc.?

- If so, what are the reporting and/or governance requirements for such organizations?

Questions Specific to Debt:

- Are variable payment obligations (demand “dividends,” royalty payments, cash flow payments, etc.) enforceable?
 - Do these run the risk of being considered “usurious” and, thus, unenforceable, under the laws of the country?
 - Is there a risk that the local government would re-characterize a debt obligation with variable payment obligations as equity? If so, what are the consequences?
- Subsidized/noncommercial interest rates:
 - Is there a risk that the local government would re-characterize a debt obligation as equity if the interest rate is low/subsidized? If so, what are the consequences?
- Governance:
 - Can Lenders have “observer” rights at Board meetings of the local companies in which they have invested?
 - At what point, if any, might a proactive Lender be deemed to be acting as an Equity Investor? What are the consequences?

Questions Specific to Equity:

- Transfer Restrictions:
 - Would local courts enforce transfer restrictions that limit (for long periods of time or perpetuity) the nature/social impact orientation of potential Equity Investors that can acquire shares in a company?
 - Can minority shareholders block social mission or material business changes in a company?
- Governance:
 - What fiduciary responsibilities are imposed on directors?
 - Are directors required to “maximize profits” or can other interests and stakeholders, such as social or environmental impact, be considered?

Endnotes

- ¹ Although this primer focuses specifically on local counsel in the cross-border impact investment context, engaging international counsel also is important when conducting a cross-border impact investment. As used here, international counsel means lawyers that are not licensed to practice law in the jurisdiction where the investee is located, but rather are licensed to practice law in the jurisdiction where the investor is located or in a financial center, such as New York or London, to name a few. Experienced international counsel can provide helpful assistance in conducting cross-border impact investments through their knowledge of the law applicable to the investor and international law, regulations, and tax issues, as well as common deal structures used in cross-border transactions. Furthermore, international counsel will likely have experience managing and collaborating with local counsel, so can provide help to most effectively engage local counsel.
- ² This primer and its attached local counsel checklist provide information of a general nature and should not be considered or used as legal advice. Investors should consult international and local counsel with appropriate experience and skill. Advice and specific investments will need to take into account and depend upon precise factual circumstances and other factors unique to the investor, investee, and others. These may include, without limitation, type of entity, nature of activities, stage of growth and applicable law and regulations.
- ³ One special consideration of relevance to even the most “commercial” impact investor is the relatively small size of many impact investments. In some cases, commercial approaches to addressing a cross-border investment risk may work well for a large deal, but become cost-prohibitive (in money or time) when applied to a much smaller impact investment. Indeed, some impact investors have foregone getting local counsel advice when structuring their impact investments because of concerns that the resulting legal bills will overwhelm the financial value of the deal. While foregoing local counsel is not advisable, the practical considerations of how best to manage legal fees and expenses when engaging in impact investing, particularly in jurisdictions without a pro bono tradition, is an ongoing challenge faced by many impact investors operating internationally.
- ⁴ See e.g., TrustLaw Pro Bono Index, available at <http://www.trust.org/spotlight/pbi15/?tab=introduction>; Lex Mundi Pro Bono Foundation, available at <http://www.lexmundiprobono.org/lexmundiprobono/default.asp>.
- ⁵ Using local counsel to ensure compliance with local regulatory requirements is essential. However as a matter of practice, compliance with rules and regulations goes beyond local counsel’s expertise, thus, an investor should also consult with international counsel to ensure that the impact investment complies not only with local regulations, but also with international regulations and any regulations of the Investor’s home country.
- ⁶ Impact investors based in the United States should also be aware that in addition to the need to be in compliance with local rules and regulations, the United States will impose separate obligations on USA investors that invest across borders. For example, USA investors are required to verify that the investee is not a person or entity listed in the Office of Foreign Assets Control’s (“OFAC”) Specially Designated Nationals and Blocked Persons List, and that the investee is in compliance with the Anti-Money Laundering standards. Investors may want to ask local counsel if compliance with USA standards are sufficient under local law, or does local law require its own or additional rules and regulations.
- ⁷ The definitions are specific to this Local Counsel Checklist and are not to be considered generally applicable in the cross-border impact investing context.
- ⁸ Anti-Corruption CEO Certificate is proof that a company’s CEO has been assessed for corruption risks and is effectively addressing such risks by implementing an appropriate anti-corruption compliance program.

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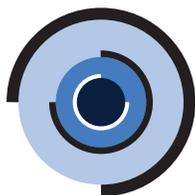
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