AN OVERVIEW OF CERTAIN LEGAL AND REGULATORY ISSUES FOR TRADE FINANCE IN AFRICA – Simon Cook, ITFA ARC Member and Partner at Sullivan & Worcester

The topic of legal and regulatory issues affecting the trade finance market in Africa is extremely wide-ranging. The following therefore is intended merely to provide an overview of certain issues affecting the African market, including:

1. a brief overview of the different types of legal regimes that exist across Africa;
2. a look at some issues around taking security and some practical and procedural matters that affect the implementation and operation of trade finance transactions; and
3. a look at some regulatory issues and what can be/is being done to improve the situation on the ground.

Differing legal regimes

A number of different legal regimes apply across the continent, the background to which is by and large historical, often being heavily influenced by the laws of the colonial powers that once operated there. On the one hand, you have the common law based jurisdictions comprising, for example, much of East Africa, parts of Southern Africa as well as Nigeria and Ghana where English law is the dominant influence. On the other, you have the civil law based jurisdictions including for example the Francophone countries in West Africa and parts of Central Africa and the Lusophone countries of Mozambique, Angola, Guinea-Bissau, Cape Verde and Sao Tome, where the legal framework has its basis in French and Portuguese law respectively.

Not all countries in Africa fit into these categories however. A number of countries are influenced by a mixture of laws. Rwanda, for example, combines both a Belgian civil law influence with English common law traits (which are becoming increasingly prevalent there) whilst the laws in South Africa and Zimbabwe reflect both their Dutch and English law origins. Lastly, when you look at North Africa, the laws there display characteristics of both the laws of other Arabic countries and either French or English law.

Whilst not specific to any particular country, it is also worth noting two other relevant sources of law. Namely, the increasing influence (albeit unofficially for the most part) of Sharia/Islamic law principles and the creation of OHADA. As regards the former, this is not only the case in North Africa, but it is also becoming more and more relevant, for example, in parts of East Africa and Nigeria where there is a significant and growing Muslim population. As for OHADA, this is an organisation which was established in 1993 with the intention of providing a framework for the implementation of legislation across the member states (originally 14 countries, but currently 17, predominantly in West Africa). It is based on the French civil law model and is heavily influenced by French procedural laws. Its laws have direct effect in the member states and there is a supranational court in the Ivory Coast for proceedings relating to OHADA laws to try to ensure consistency of application across member states. Over recent years, the OHADA system has recognized certain benefits of operating within a more anglophone style framework and has brought in laws to allow certain goods to be held under an agency arrangement on behalf of a group of potentially changing financiers akin to the concept of a "security trust".

There are marked differences in approach between the common law and civil law based systems, with the latter for example being more debtor friendly and more prescriptive in matters relating to procedure and the taking and perfecting of security, all of which can affect the types of financings commonly seen in the trade and forfaiting markets. The important point to note here is that with over 50 countries in Africa applying a number of different styles of legal regime, there is no single approach to looking at legal and regulatory issues. Precisely the opposite in fact and, whilst many of the issues are familiar to those with experience of English and other

European laws, it is crucial to engage with counsel in the jurisdictions relevant to a financing to ensure not only that all the applicable issues are noted in good time but also that the correct interpretation is received.

Some legal considerations

Taking security

The typical security in trade transactions is security over all or a combination of the following assets:

• physical assets/commodities;
• transportation/storage documents (including bills of lading and, in some case, warehouse warrants);
• contractual rights/receivables; and
• banks account(s).

When taking security over physical assets, this is likely to be onshore and therefore governed by local law. The same fundamental principle for taking this type of security applies whether you are in a common law or civil law environment in Africa, namely that the party with the benefit of the security must have possession (actual or constructive). However, where a transaction is reliant on security over physical assets on a revolving basis or over future physical assets, this is one area where a distinction between common law and civil law jurisdictions arises. Generally speaking, in English common law based jurisdictions (for example, Tanzania and Kenya), the security need be taken only once and it will apply to future or revolving assets as they come into existence provided the possessory criteria is met. There is no need for additional documentation. In civil style jurisdictions, however, it can be a little more complicated.

In Mozambique, for example, it is necessary to renew a pledge each time future or revolving assets come into existence. This may require a new security document to be entered into with the practical issues of re-execution as well as re-registration and stamping with the associated costs. Even where this is not the case, at the very least a formal written process for asset identification is required of the parties to ensure the future/revolving assets come within the terms of the pledge which, if nothing else, can be administratively burdensome.

In DRC, it is necessary in some circumstances to take a lease over land on which pledged goods are located. Often warehousers are able to assist in the taking of security over warehoused goods, though this only works if the warehouser is independent so as to give the bank constructive possession. Independent warehouses are not as common in parts of Africa as elsewhere and therefore achieving possession can be difficult unless a collateral manager is involved to oversee the storage of the relevant goods. This, however, comes at a cost and may not always be practical especially if goods are up country or the volumes involved don't merit the associated costs of the collateral management. One other issue associated with security over warehoused goods is the question of co-mingling. In many if not all of the common law based jurisdictions, co-mingling of the same type/grade of goods should not by itself have an adverse impact on a security interest over part of those goods provided that the aggregate volume of co-mingled goods was no greater than the volume of goods purported to be secured under all relevant security interests taken. This, however, is not the case under the laws of most civil law jurisdictions where there is likely to be an adverse impact, especially if the goods are co-mingled with other goods owned by the grantor of the security.

As part of a typical export-based transaction sourced out of countries without port access, it is common for goods to be transported across a number of countries before they are exported. This is important as a significant number of countries in Africa are landlocked or have inadequate port facilities. This creates a number of issues when structuring financings, not least of which is how to take security over the goods in transit across potentially multiple borders. Not only will the goods be located in different countries during transportation but there won't be any document of title representing the goods. Which governing law do you choose? How do you keep "possession" of the goods? The short answer is that it is so difficult, impractical and costly to achieve continuous security in this scenario that parties commonly don't try to do so. Instead they focus on control, for example through a collateral manager or even the transporter, until such time as effective more easily implemented security is available at the end of the transit period. During the interim, arrangements with FCRs or other transportation documents may be possible. After this, it may perhaps be in a warehouse at the port or on board ship when bills of lading would be issued. In the latter case, the lender can take security over those documents and the goods on board ship and, in most cases, this would be done by way of an English law pledge.

In terms of receivables, there are also differences in treatment depending on the jurisdiction(s) involved. The main two points to note here are the ability or otherwise to take security over future receivables and the procedural requirements relating to perfection of security. At the risk of generalising, it is fair to say that most civil based systems don't allow the taking of security over future receivables. This is equally true of those countries where there is an Arabic influence such as in most of North Africa. This is not surprising given it is consistent with the principles discussed above in relation to taking security over a revolving set of physical goods and means that steps need to be taken each time a new set of receivables arise which is intended to be caught by the security. These steps range from new security being required each time in certain jurisdictions whilst, in others, a hybrid approach requires written documentation, falling short of a new security interest, being effected by the parties to identify the new receivables and confirm they are subject to the security already in place. As with revolving assets, this may result in re-registration requirements with the associated costs that that entails.

Likewise, there are additional procedural requirements for perfecting security over receivables in many civil law jurisdictions. For example, Francophone and Luosphone jurisdictions almost always require notices of assignment of receivables to be served through an official – the equivalent of the French huissier or bailiff. It is also necessary to achieve a date certain on the notice of assignment so as to ensure it is enforceable against the assignor. This is in contrast to the approach applying in the common law jurisdictions where it is only necessary to be able to evidence the fact that notice is given either through an acknowledgement of the notice by the debtor or by delivery being recorded (for example, delivery by registered post or courier).

Another potential issue in some civil law jurisdictions is the inability to obtain certain types of security interests. For example, the trust concept does not usually exist in civil law jurisdictions in the same way as it does in common law jurisdictions. As a result, creating structures which rely on trusts (for example, trust receipts) is unlikely to provide the comfort intended. Also, floating security is difficult in a number of countries – Benin for example has particular difficulties with this concept – meaning that taking security over a variety of assets is costly and time-consuming as different security documents for different types of assets would be needed, each having to be stamped and registered.

Notarisation/legalisation

As mentioned, civil jurisdictions tend to have a lot of formalities and procedural requirements and civil jurisdictions in Africa are no different. However, in an African context, it is not only those jurisdictions but also many common law jurisdictions that suffer from this. One area affecting civil and common law systems which causes logistical and cost issues is the requirement in certain circumstances for documentation to be notarised and/or legalised. The requirement may arise from the fact that a document needs to be registered and therefore must be notarised (mainly an issue in civil systems) but it may also arise as a result of the execution process itself. If a party is signing under a power of attorney, that power of attorney may have to be notarised. This is common in Arabic countries in particular but also some Francophone and Lusophone jurisdictions. It is even a practical requirement in some common law countries such as Uganda and Tanzania. Whilst not strictly a legal requirement to have corporate authorities notarised and/or legalised, the registrars there have refused to register security in the past if this was not provided since they wished to confirm the validity of the corporate authority. This is not part of their role, but from a practical perspective it is best to find out first and do as requested rather than try to argue the point.

In many jurisdictions, both civil law and common law, if execution is to take place outside of the country of the obligor (where the lender would be looking to enforce), then it is often necessary to have the document notarised and then to have that notarisation process authenticated through ministries and embassies in the country where execution took place and the country of the obligor in order for it to be enforceable in the latter. This can be a time-consuming and costly process with the only alternative being for signatories to travel to signing meetings in the obligor's country to avoid the requirement. However, if there are multiple obligors in multiple jurisdictions, you cannot all sign in one country. In that situation, analysis is needed to see what the best options are and local counsel would need to be involved otherwise it could be potentially a very costly exercise.

Enforcement

The usual questions regarding enforcement arise in an African context as they do anywhere else in the emerging markets. What is the best way to enforce in an African context? Is it better to arbitrate or should you submit to the jurisdiction of the courts? Can you enforce foreign judgments? What specific enforcement procedures will apply in country? How long will it take and how costly will it be?

There are a number of considerations when deciding whether to arbitrate or go through the courts. Whilst there are some countries in Africa that are not party to the New York Convention 1958 (the "Convention"), including Libya, the majority of countries are party to it and therefore would in principle enforce foreign arbitral awards. Obviously for those countries which are not party to the Convention, you are likely to be better served going through the courts so that you can enforce locally. However, where both options would work, other matters are relevant. For example, can you enforce foreign judgments in the relevant country or, if not, will the local courts apply English law as the chosen law? As regards English judgments, there are certain countries that will in principle enforce them (most of the Anglophone jurisdictions, Mozambique, Morocco and Egypt for example). However, there are also a few others (Zambia for instance) that would not usually do so. Most jurisdictions, though, would apply English law were any action on an English law document to be taken in the local courts, but there are nevertheless likely to be linguistic and other logistical issues outside of English speaking Africa.

In the common law jurisdictions, and in Morocco/Egypt, self-help remedies are available including private sales of secured assets. In the civil jurisdictions and in the rest of North Africa though, this isn't the case as a general rule even to the extent of requiring public auction sales of secured assets in most cases. On the other hand, arbitration can be very expensive depending on what rules are agreed for the arbitration. Also, there is no equivalent of the summary judgment option available through the courts, at least in common law jurisdictions, so you tend to have to go through the same process and timelines irrespective as to the nature of the dispute. This means that some matters can be dealt with more quickly and cheaply through the courts, whilst others will be easier and cheaper if arbitration is used, especially where tight but reasonable timelines and evidential processes are incorporated into the arbitration process. As ever, the question of courts vs arbitration needs to be considered on a case by case basis.

Some regulatory issues

Exchange controls

In terms of FX controls (the ability to control and potentially block the transfer of hard currency offshore), it is fair to say that there is a real cross-section of positions on this. Whilst there are very few countries in Africa that have no FX controls (Egypt is one however), there are a number of countries (in particular the rest of North Africa) where the rules are not really aimed at foreign investors and the requirement is more one of registration than formal analysis and approval. These rules are that prohibitive and the intention there tends to be to stop the flight of cash by the indigenous population rather than prevent lenders being repaid. A third category are those countries that require formal approval and the difficulty or otherwise of getting the approval varies from country to country. It is a relatively straightforward process in South Africa for example (though only certain domestic authorised parties can carry out this process for offshore lenders) but incredibly inefficient and difficult in Angola. In some cases, such as Mozambique and Malawi, a form of pre-approval is required in certain circumstances, potentially delaying the signing of finance documentation for weeks or longer so the impact can be quite significant from a timing perspective.

Stamp duty/registration

The position regarding stamp duty and registration fee levels across Africa also provide a wide spectrum. In some cases, such as Tanzania and Zambia, the level of these costs is nominal. However, in some cases, such as Nigeria, the level can be very high to the extent that certain security may not be taken or may not be stamped at the time it is taken. Angola has relatively recently changed the level so has improved its situation but it is still at the higher end of the range. Most countries fall into the middle ground of having either stamp duty or registration fees (it is very rare to have both of these amounts calculated on an ad valorem basis) at a level between 0.1% and 0.9%. This is one area where there isn’t really and distinction between common law and civil systems with, for example, Kenya, Mozambique, Malawi, Uganda, Benin and the Ivory Coast all coming in within this range.

As ever, borrowers will try to minimise stamp duty payments and in some cases it is possible either to upstamp or defer the time of payment of stamp duty. Local advice should always be taken on a case by case basis as even within the same country different rules may apply to different documents. There are even requirements in a couple of cases (Tanzania and Uganda for instance), where the facility agreement itself may be subject to stamp duty in certain circumstances.

Improvements coming?

There are a number of initiatives across the continent at the moment to alleviate some of the issues referred to in this article. I said that Angola had relatively recently revised its stamp duty requirements downwards and many other countries are currently looking at doing the same thing to try to make financing their corporates more straightforward and less costly. Other countries are looking at a series of changes to their warehousing laws to make warehouse financing more viable and to allow better financing terms to go further up the chain perhaps even to the farmers direct. The ideas being considered are the implementation of warehouse receipts programmes, the establishment of commodity exchanges (where countries are currently looking to follow the success in Ethiopia and Ghana in this area) and the use of electronic warehouse documentation.

In other jurisdictions, the authorities are looking at allowing more self-help remedies to be available and also to move more towards private sales on enforcement rather than cumbersome (and potentially less economic) public auction sales. A general streamlining of court processes and inefficiencies are also an on-going project in a number of countries, both common law and civil law jurisdictions. This will all take time though so for the moment, it is a case of working with current systems but watch this space.

Some final thoughts

There are a lot of misconceptions about the difficulties of doing business in Africa. Certainly it is not without its issues as I have alluded to in this article, but it is after all a large and diverse group of emerging market countries and dealing with these types of issues is part and parcel of working in these types of markets. From a legal perspective, it is no more difficult (and in many cases a lot easier) than doing trade finance business in other emerging markets. The legal regimes are generally sound, if somewhat prone to burdensome procedural requirements in places, and there are traps for the unfamiliar. However, there is a lot of positive news – many more institutions are focusing on Africa especially given the difficulties elsewhere in the world and there is much there that needs financing in Africa. There is a huge need for infrastructure and processing capacity and the value chain needs financing all the way up to the producers/farmers. The types of potential risks and the deal processes are the same in Africa as they are for any other emerging market, but with proper due diligence and structuring. there ought not to be too much cause for concern.