

# DEFINITIVE EXPERTISE

REFLECTIONS ON THE WORLD  
OF BUSINESS AND FINANCE IN 2015





# WELCOME

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In just a few years, FTI Consulting has grown to become one of the pre-eminent multi-disciplinary consulting firms in the world, helping clients to anticipate and overcome complex business challenges in areas such as forensic investigations, litigation, regulation, reputation management and business restructuring.

We have been a trusted advisor during some of the most memorable events in recent history, including landmark celebrity legal cases, international crises and disputed presidential elections.

Given the nature of our work, our professionals have lived and worked behind the scenes, and behind the headlines, for nearly three decades. We've been integral to our clients' success but often invisible to much of the outside world. Yet our experience and expertise enables us to offer valuable insights into a range of critical business and economic issues.

Throughout 2015 our experts in Europe, the Middle East and Africa published a wide variety of papers which we have republished in this review of the year. We hope you find their insights as informative, thought-provoking and enjoyable as we have.



Chris Osborne



Kevin Hewitt

**Co-Chairmen, FTI Consulting EMEA region**



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# FIFA World Cup: **An Own Goal**

FIFA, football's world governing body, was engulfed by accusations of widespread corruption in 2015, after the US Department of Justice indicted several top executives and its President Sepp Blatter became the subject of a Swiss criminal investigation.

This all occurred after FIFA had conducted its own investigation into the awarding of hosting rights for the 2018 and 2022 World Cups and found no evidence of wrong-doing. In this article, Andrew Durant explained how FIFA's internal inquiry was a textbook example of how not to conduct an ethics probe, and what best practice might look like.



The rift between former US Attorney Michael Garcia, who led the investigation, and FIFA Ethics Committee Chairman Hans-Joachim Eckert over the contents of Eckert's summary findings last week, has raised accusations of a whitewash and brought further scorn on the reputation of FIFA. Earlier this week, FIFA asked Swiss authorities to launch a criminal inquiry into the circumstances surrounding the bidding process.

### INVESTIGATORS NEED TO BE UNMARKED

The first lesson concerns the scope of the investigatory powers granted at the outset. Credible investigations need the power of inquiry and the ability to obtain relevant documents. In the FIFA case, the lack of subpoenas meant that potential targets, staff and other witnesses who were unwilling to cooperate could not be compelled to do so. In addition, it appears that documents were handed to the investigators, which is likely to have resulted in some pre-selection. Best practice is for the investigators to "seize" a wide population of potentially relevant documents and to whittle them down to key documents.

### SPEED IS OF THE ESSENCE

The speed at which an investigation is carried out is central to its success. Any delays between the issues coming to light and the investigation commencing mean it is more likely that memories will fade and documents will be misplaced, lost or destroyed. The allegations of corruption first surfaced in a Sunday Times article in October 2010 some four years before the summary report was published. And Garcia was appointed in July 2013 and appears to have commenced the investigation in or around October 2013.

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## FIELD OF PLAY SHOULD BE BROAD

The next point involves the potential depth of the investigation, including the number and range of witnesses interviewed, and the way in which interviews are carried out. There are several observations that can be made here:

- The investigation comprised just 75 interviews, including many of the 24 country representatives of the football governing body. Given that the inquiry related to eleven bidding countries (in nine groups), far in excess of 100 interviews might have been expected.
- Any comprehensive investigation will involve interviews of junior staff, including personal assistants and members of the team at all levels. Junior members of staff often provide insights that senior staff cannot, and they can flag up the whereabouts of key documents and other evidence. In the case of the FIFA investigation, the number of junior staff interviewed appeared to be thin on the ground.
- The most effective interviews are those that are conducted face-to-face so that interviewers can, amongst other things, read and assess body language and ask follow up questions as the interview unfolds. In the case of the FIFA probe, many interviews took the form of written Q&As, giving respondents the advantage of careful preparation.

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INFORMATION.

## TENACITY REQUIRED IN ACQUIRING DATA

If FIFA investigators were restricted in the scope of witnesses they were able to interview, then they were even more limited in the range of information they could access.

In particular:

- Just 200,000 documents, mostly in hard copy form, formed the basis of the football body's inquiry, a surprisingly narrow pool of information. In the digital age, there is an expectation that e-mails and other electronic documents – including drafts of the hard copy documents that were evaluated as part of the investigation – would be available.
- Computers containing information crucial to the FIFA investigation were destroyed, and they were apparently not able to obtain back-up copies of information kept by individuals, on server tapes, or on the cloud and other remote data systems. At the very least, best practice suggests that future inquiries use greater tenacity and perseverance to access data.

## WHISTLE-BLOWERS, GIFTS AND INDEPENDENCE

There are several other lessons that can be learned from the FIFA experience, the first of which is the importance of engaging with whistle-blowers, encouraging them to talk and protecting their identities if they do engage. Those referred to in the FIFA probe appear to have been castigated, not a useful precedent for future investigations. One wonders how many were turned away, or who decided to keep their “head below the parapet”?



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In addition, given that corruption became a key focus of the FIFA investigation, rules on gifts and entertainment appear to deserve much closer scrutiny than they received in the report. This offers another learning point for future investigations.

Finally, one of the basic rules of setting up an investigative committee (in this case the “chamber”) is that members should be independent. The chamber should also report to individuals who are, again, independent. This clearly was not true in the case of FIFA, where conflicts arose in many areas.

The FIFA investigation was meant to restore the organisation's reputation and underscore a sense of fairness. So far it appears to have failed on both counts. Future investigatory bodies should take note.

**Andrew Durant** is a Senior Managing Director in FTI Consulting's Forensic & Litigation Consulting practice in London.

### Vulnerable customers:

# **Why boards and senior executives must take action now**

In February 2015 the FCA published an Occasional Paper regarding Consumer Vulnerability, which was widely viewed as an warning to boards, senior executives and senior retail banking leaders of the significant rise in expectations for their treatment of customers.

If banks don't change their policies and practices in this area, the regulators could take enforcement action in the very near future. In this article, Jeannette Lichner and Peter Brooke examined the key themes and practical challenges which arose from this Occasional Paper and why firms must take action now.



Having received limited media coverage, and with a somewhat theoretical tone, it is all too easy for this emerging risk to be relegated to the 'later' section of an already all-too long priority list. But that would be a big mistake, as this is an issue which is being given significant thought and attention by the FCA.

It is currently developing a regulatory, supervisory and enforcement approach to protecting vulnerable consumers that will enable it to take action against culpable firms very soon. To date, it has already issued at least four Enforcement Actions which referred to the treatment of vulnerable customers, and vulnerable consumers featured prominently in the FCA's 2015/16 Risk Outlook.

Consequently, vulnerable customers are likely to be a significant political, regulatory and reputational issue in the coming months and years, with the very real prospect of fines and the need for delivering large-scale remediation programmes (after the PPI and Swaps scandals). Firms need to focus now on what they need to do, and how they can incorporate this emerging risk into their existing regulatory change management and conduct risk agendas. If firms delay any longer, in order to 'finish their current conduct projects' (as several firms have told us) then this will inevitably result in unnecessary expense and even greater project fatigue.

In its simplest form, firms will need to establish systems and controls that identify vulnerable customers and provide evidence that their needs are being taken into account. This means demonstrating that all conduct risks for these customers are being effectively managed and mitigated.

### THE SCALE OF CONSUMER VULNERABILITY IN THE UK

**1 in 4 adults** have a mental disorder

**Almost 50%** of adults have numeracy attainment of **age 11** and below

**Around 1 in 2 adults** lack sufficient savings to cover an unexpected bill of **£300**

**Over 1.4m people** are aged over **85**

**1 in 8 adults care,** unpaid, for family and friends' dementia

Source: FCA Occasional Paper No.8 Infographic

It cannot be overstated that this is not an issue to be owned and led by compliance departments. It is a fundamental issue that needs to be embraced and driven by the entire business, with the support of compliance.

FIRMS WILL NEED TO ESTABLISH SYSTEMS AND CONTROLS THAT IDENTIFY VULNERABLE CUSTOMERS AND PROVIDE EVIDENCE THAT THEIR NEEDS ARE BEING TAKEN INTO ACCOUNT.

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## WHAT MAKES THIS CHALLENGE SO COMPLEX?

Identifying and addressing vulnerable customer issues is not straightforward:

- **Whilst the FCA has provided a definition of a ‘vulnerable customer’, determining who qualifies, and when, is complex.** The FCA defines a vulnerable customer as “someone who, due to their personal circumstances, is especially susceptible to detriment, particularly when a firm is not acting with due levels of care.” Yet a wide range of consumers are likely, at least at some point(s) in their lifetime, to be captured by this definition. The FCA suggests that up to a third of the UK population could fall under the definition at any given time. Identifying a vulnerable customer, particularly when customers may not want to be labelled as such or give any indication of their vulnerability, may be challenging for firms.
- **Vulnerability is not necessarily a constant state.** There are some types of vulnerability which are constant, but for many customers vulnerability could be episodic and inconsistent, reflecting their circumstances at a particular moment.
- **Firms will be required to show that a customer’s potential for vulnerability has been proactively considered throughout a product’s lifecycle, not just at the point of sale to the customer.** Firms will bear the burden of proof for this, not the customer. This presents a challenge for firms, which is why they should start addressing the issue now. In order to effectively manage this requirement within a stated risk appetite, firms may have to change their business models, product and service offerings, and be able to review a customer’s portfolio of services regularly.
- **Relying on the law is not enough.** The FCA’s conduct risk approach, which is top-down and principles-based, will present a much greater challenge to firms than the already complex mix of legal requirements. Any existing legal approach will likely be insufficient to meet the challenge posed by the increased regulatory focus. Greater complexity is added because the law and principles-based regulation are not necessarily aligned.

## QUESTIONS TO BEGIN ASKING NOW

- Here are some questions boards and senior executives should be thinking about:
- How does the firm monitor customer vulnerability throughout the product lifecycle?
- How does the firm make a holistic assessment of vulnerability without writing down too much or too little?
- What makes someone qualified to make a judgement/decision around vulnerability? How about the impact on a service/product?
- How do you handle a situation where the firm and customer disagree on whether the customer is vulnerable? How does the firm handle the risk to the customer of being deemed vulnerable?
- How best to strike the balance between flexibility and consistency when handling customers?
- What impact does this have on processes, and product features?
- How should the firm approach its legacy products?
- How does the firm manage complaints from vulnerable customers?
- How does the firm get the right balance between legal obligations and regulatory expectation?

## WHAT BOARDS AND SENIOR EXECUTIVES SHOULD BE DOING NOW

It is imperative to consider how expectations around vulnerable customers are met and a path for embedding appropriate systems and controls, in conjunction with the wider conduct risk agenda and business strategy, is put in place. Critical steps we recommend include:

- **Full engagement by the board and senior executives to ensure common understanding of expectations.** This includes understanding the risk of not acting and the potential competitive advantage of acting early.
- **Holistic evaluation of the meaning of the Paper and implications for the firm.** This includes revenue generation, as well as the legal, compliance, human resources and technological requirements.



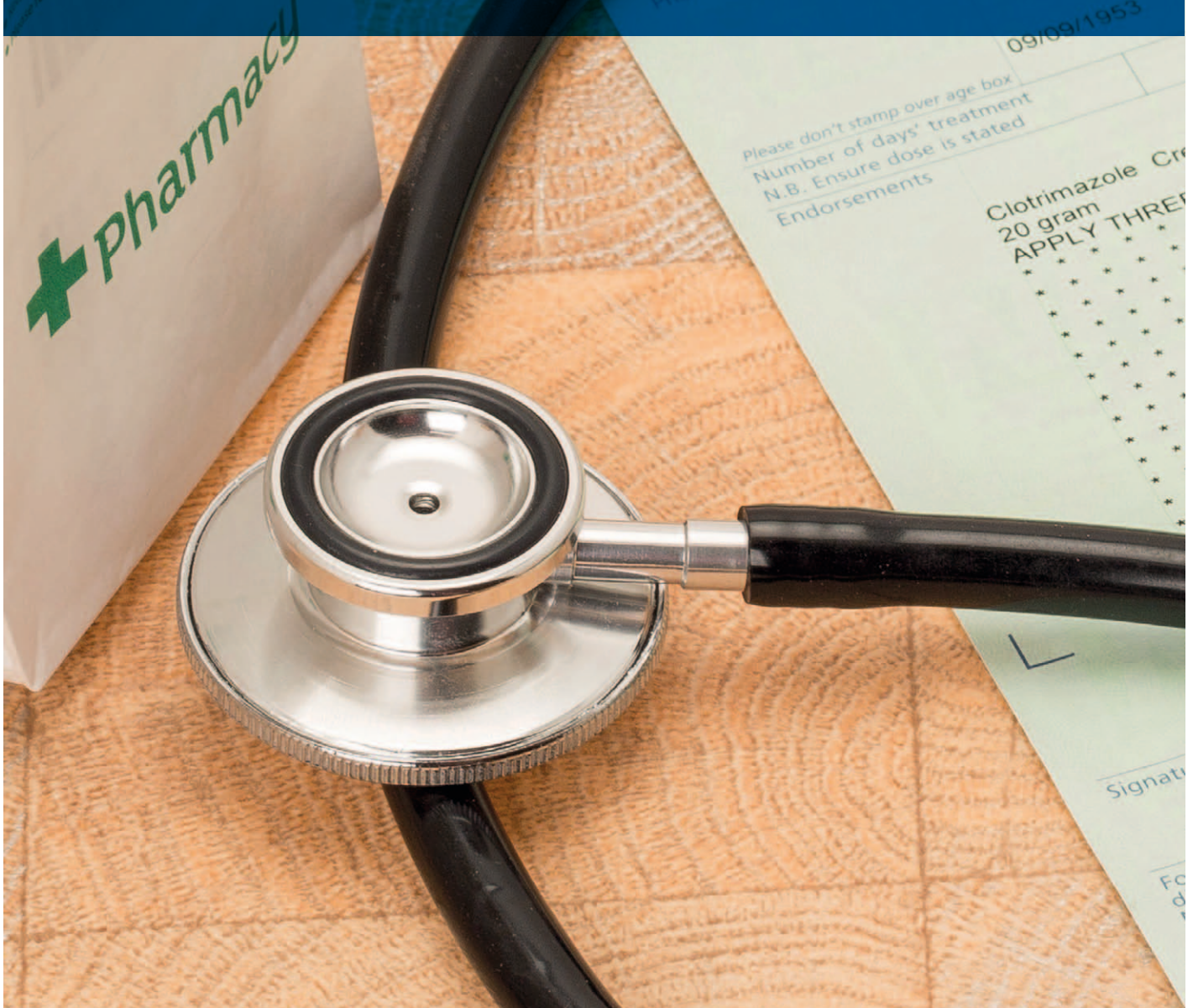
- **Utilising the existing, (or emerging) conduct risk management framework.** In reality, these new requirements merely add to the complexity of delivering the right outcomes to clients. Firms do not need to start from scratch, but the framework needs to be comprehensive and address governance arrangements, policies and procedures, complaints handling, product design, and customer service.
- **Consider what technology changes will be required to view the customer relationship in its entirety.** Critical here is having the right systems in place through which vulnerability can be identified.
- **Consider employees who are in client-facing roles.** How they will be supported and trained to help them identify potentially vulnerable customers?
- **Take legal advice.** All documentation relating to policies, procedures and processes will need to comply with legal aspects of data protection, equalities law, mental health, and consumer protection. This will all pose additional challenges. If a customer requests to see certain personal information, and it is deemed to be discriminatory, the firm will be at risk. The possibility of a legal challenge from a disgruntled customer who was denied access to a product because of a 'perceived' vulnerability is all too real.

This is the beginning of a new journey aimed at delivering good customer outcomes. Firms need to take action now to avoid the potential future regulatory and reputation damage which the FCA has indicated will occur if they do not take vulnerable customer needs into account in their business models and risk management programmes.

**Jeannette Lichner** is a Senior Managing Director and **Peter Brooke** is a Managing Director in FTI Consulting's Forensic & Litigation Consulting practice in London

# Lessons from NEW Devon: **Most Capable Provider vs a competitive process**

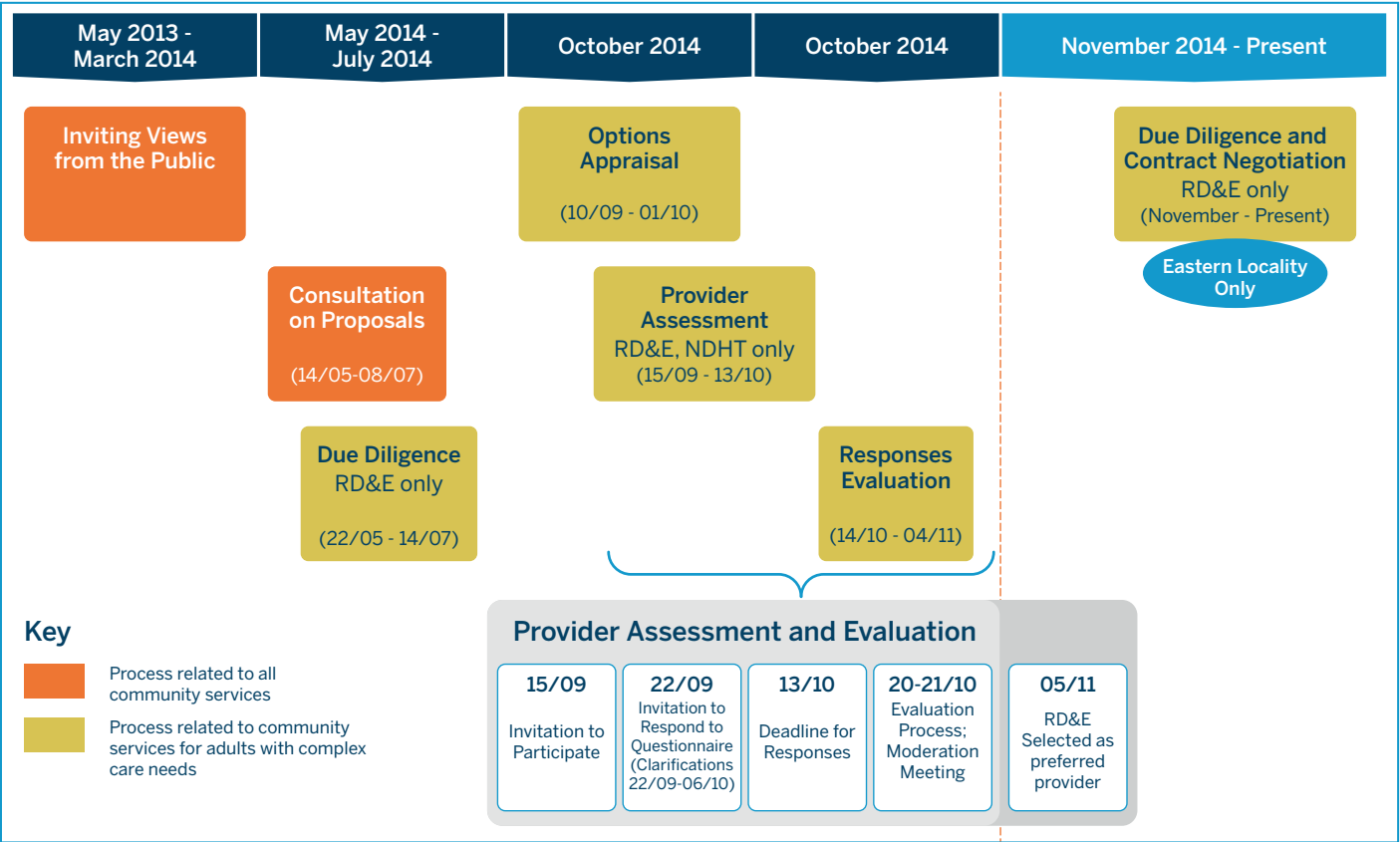
In August, Monitor's investigation into NEW Devon CCG's commissioning of community services in Eastern Devon found no breach of procurement, patient choice and competition regulations. However, whilst this decision has left the door open to the continued use of most capable provider, Schellion Horn argued that there are still strong arguments in favour of using a competitive process.



NHS Northern, Eastern and Western Devon Clinical Commissioning Group (NEW Devon CCG) is one of two CCGs in Devon and is the largest CCG in England in terms of population. The CCG divides the area it covers into three localities (northern, western and eastern) and in May 2013 began undertaking a programme to transform community services in Devon. This included undertaking a procurement process to select preferred providers for community services for adults with complex care needs. Procurement processes were commenced separately for each of the three localities.

There is a complex provider landscape in the region. In northern and western Devon the preferred providers are the incumbents. These are Northern Devon Healthcare NHS Trust (Northern Devon) and Royal Devon and Exeter NHS Foundation Trust (RD&E) respectively. In eastern Devon, services are currently provided by Northern Devon under

a contract that was due to expire in September 2015, but which has been extended on a temporary basis. However, RD&E has been selected as the preferred provider for the new contract. The complaint raised to Monitor by Northern Devon only relates to the eastern locality where there is a proposed change in provider.



Source: Monitor, extracted from NEW Devon CCG's strategic case



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## WHAT WAS THE PROCUREMENT ROUTE?

NEW Devon CCG opted to use a Most Capable Provider (MCP) procurement route for each of the three localities. This involves the identification of a preferred provider who is the “most capable” of providing services, including consideration of best value for money, and proceeding to negotiate the contract with them as opposed to going through a full competitive tendering process.

In respect of eastern Devon, the procurement process consisted of three phases: (i) inviting views from the public; (ii) communications with Northern Devon; and (iii) publicly consulting on NEW Devon CCG’s proposals.

The options appraisal included an evaluation of three potential procurement options:

- Awarding the contract to the current providers.
- Competitive tendering.
- MCP.

An MCP process was chosen, with invited providers being asked to respond to six questions. These responses were evaluated, with RD&E receiving a score of 68 and Northern Devon a score of 57.

## THE PROCUREMENT COMPLAINT

In January 2015, Monitor opened a formal investigation into NEW Devon CCG’s procurement of community services in eastern Devon following a complaint from Northern Devon. They complained about the process on the following grounds.

- It did not appropriately consider best value for money, in that the evaluation criteria did not include any financial assessment.
- It was not truly competitive.
- It was not transparent and failed to treat providers in an equal and non-discriminatory way.
- It may have been open to conflicts of interest.

Northern Devon claimed that the decision to select RD&E as the preferred provider and the decision-making process itself were not consistent with the Procurement, Patient Choice and Competition Regulations.

These regulations are intended to allow commissioners to decide how to secure services in the best interests of patients. Monitor notes that, whilst they must act within the

regulations, “it is for commissioners to decide what services to procure and how best to do this within the framework of the regulations”.

Furthermore Monitor notes that “competition should be employed where it serves the interest of patients, and is not an end in itself. The regulations do not impose competition on the NHS. No one will be forced to put services out to competitive tender and there are circumstances in which there might only be one capable provider of care. Commissioners need to make balanced judgements, taking account of a range of factors in the local circumstances – there is no “one size fits all” approach.”

This gives commissioners flexibility with regards to the procurement route and therefore allows for a process other than a competitive tender. However, the choice of procurement route must take into account local circumstances and the four key commissioning principles:

- Securing needs of patients, improving quality and efficiency, including through providing services in an integrated way.
- Acting transparently, proportionately and in a non-discriminatory manner.
- Choosing a provider who is most capable of delivering the overall objective and best value for money.
- Considering ways of improving the service – including through enabling providers to compete.

## WHAT DID MONITOR CONCLUDE?

Monitor’s analysis covered issues of fairness and adequacy of the CCG’s process, equal treatment and non-discrimination, transparency and conflicts of interest.

Monitor concluded that there had been no breach of the Procurement, Patient Choice and Competition regulations. However, before entering into a contract with RD&E, Monitor requires NEW CCG to carry out further work on the economic case for selecting RD&E, in particular on the following areas:

- The service scope and pricing arrangements.
- Evaluation of value for money.
- Satisfying itself and the public that this is the best way to secure the needs of patients and improve quality and efficiency.

### IMPLICATIONS OF MONITOR'S DECISION

Monitor's decision has implications for the award of this particular contract by NEW Devon CCG and also more widely for CCGs who are considering procurements.

#### Implications for NEW Devon CCG, and the procurement of services for adults with complex care needs

Although Monitor determined that NEW Devon CCG had not breached the regulations, the CCG failed to make an economic case for the chosen provider. As such, they have been required to undertake additional work to justify the decision and to show that it is in the best interests of patients, particularly on a value for money basis.

If this further analysis does not support the award to RD&E, it would follow that there may need to be a new procurement process which would further delay the contract award. A question has also been raised by some commentators as to whether making the economic case at this late stage, in effect supporting a decision which has already been made, could lead to further accusations of bias and conflict of interest.

#### Wider implications for procurement in the health sector in general

Monitor's decision leaves the door open for the use of MCP by CCGs. Indeed, it appears to leave significant latitude for such an approach. However, the fact that the economic case is still unproven means that CCGs have not been given a "green light" for unfettered use of MCP. All CCGs undertaking an MCP process would be wise to continue to ensure that they comply with, and are seen to comply with, due process.

First, MCP as a procurement route should be evaluated against other procurement routes in respect of the particular service contract. Market testing in some form is likely to be required and an MCP process may be particularly relevant if there is only one or a very small number of providers who are able to provide the service to the necessary standard.

Second, if an MCP route is selected as being most appropriate following a well-documented options appraisal process, then it must be applied thoroughly. A rigorous evaluation process should be used to determine the MCP and it must be transparent and easily understood by all parties. CCGs should be able to demonstrate that the processes they have used are robust, fair and non-discriminatory. Potential providers should be asked to respond to questions that are clearly linked to service outcomes, and that are accompanied by a detailed service scope. It is recommended that financial assessment

is undertaken upfront – recognising that best value for money should be one of the key success factors that should be considered. If, following this process, a single MCP cannot be clearly identified, then it may be necessary to consider whether a competitive tender process may be more appropriate.

Given the financial vulnerability of the health sector, we expect to see further procurement challenges – particularly where incumbent providers are not selected as the preferred provider and the lost revenue stream could push them into financial distress.

### KEY ISSUES FOR CCGS CONSIDERING AN MCP PROCESS

- MCP should not be viewed as an easy option compared to a competitive tender. There are circumstances where it is a valid procurement route, particularly where there is only one suitable provider, but it should be considered alongside other options and chosen on its merits.
- An MCP process must be seen to be implemented in a robust, fair and transparent manner.
- Upfront consideration should be given to potential conflicts of interest and mitigating actions taken where necessary – such as involving a third party in the evaluation process.
- An outline service specification should be developed upfront and advertised.
- CCGs should develop critical success factors (CSFs) for the service provision and providers' capabilities should be evaluated against these – this requires evaluation questions to be developed which link directly to the CSFs and service outcomes.
- Evaluation should include an initial financial assessment, with a focus on best value for money.
- A paper trail should be kept documenting the process that has been undertaken and the evaluation criteria.

**Schellion Horn** is a Managing Director in FTI Consulting's Economic and Financial Consulting practice in London.

## Anti-Money Laundering: **Russian and Eastern European Clients in the AML/Sanctions Crosshairs...Again!**

The UK's apparent willingness to do business with individuals and their companies from Russia and Eastern Europe makes life difficult for Money Laundering Reporting Officers (MLRO). The UK government indicated its intention to clamp down on real estate and complex structures, but will those intentions stick?

Andrew Jackson explored the challenges of doing business with 'persons' originally from those jurisdictions.



The recent case in Jersey, AG v Jardine, in which an MLRO was prosecuted for failing to report potential money laundering suspicions, has brought into sharp focus some core AML compliance challenges.

The Jersey legislation under which this prosecution was brought is consistent with the UK Proceeds of Crime Act. The case involved the handling of an application on behalf of a Ukrainian Politically Exposed Person (PEP) and funds indirectly routed through a company incorporated in Belize via a trust company based in Cyprus. The prosecution argued that as the application and funds originated from a PEP the application should have been treated as suspicious – not just high risk and subject to monitoring. Mrs Jardine was the MLRO of the Jersey-based financial institution where the application was made and which received the funds in question. Mrs Jardine and her employer undertook a risk-based assessment of the application but with no clear connection between the applicant and the source of funds, they were returned and the application did not proceed further. It was argued that in the circumstances, there were reasonable grounds for suspicion and the MLRO was therefore obliged to make a report to the authorities, which she failed to do.

In this case, the authorities were potentially setting an alarming precedent by signalling that the thresholds for suspicion needed to initiate a report are extremely low. In fact, going as far as proposing that PEP status, especially in an Eastern European context, is sufficient.

### THE DANGERS AHEAD

It is an ongoing challenge to identify potential money laundering and other financial crime risks when taking on new customers, as well as in existing customer bases. The Financial Conduct Authority is particularly keen for firms to establish how individuals have become wealthy, especially high profile and high-risk customers, including PEPs.

As London is an attractive destination for wealthy Russians and Eastern Europeans, banks will be competing to tap into this lucrative market. However there are dangers for those banks that are less than diligent in evaluating the risk of a client and monitoring ongoing business done by those clients.

A major issue regarding the Eastern European market is the lack of transparency surrounding the whole-scale transfer of state assets into private ownership after the end of communism. This was a concern for UK banks approached by the first wave of oligarchs in the late 1990s. A number of these original oligarchs have since developed a significant media presence in the press, TV and online, which has made due diligence seem easier, even if the original source of wealth is unclear.

However, any further influx of wealthy Eastern Europeans is likely to increase the due diligence challenge because they are almost unknown in the West at present. The career histories of the new breed of oligarch are remarkably consistent – an obscure academic or technocrat rises rapidly through the ranks of the emerging economy accumulating significant wealth along the way.

AS LONDON IS AN ATTRACTIVE DESTINATION FOR WEALTHY RUSSIANS AND EASTERN EUROPEANS, BANKS WILL BE COMPETING TO TAP INTO THIS LUCRATIVE MARKET.



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There are hurdles to be overcome when remitting funds to the UK, particularly as anti-money laundering checks have become far more stringent in recent years and are no longer perceived to be merely a tick-box exercise. Hidden amongst the wealthy Eastern Europeans will be money launderers, tax evaders and sanctions violators. However, determined criminals will not be deterred by the banks' new customer checks and will readily provide plausible information and credible information.

Anyone conducting background checks may be directed to the oligarchs' company websites, intended to create a veneer of legitimacy and respectability, whilst leaving questions about the origins of their wealth unanswered. Anecdotal evidence suggests that some oligarchs routinely sweep the internet and "sanitise" their profiles, and the recent rulings regarding the "right to be forgotten" are likely to increase the effectiveness of this activity. The absence of a meaningful profile for a supposedly wealthy and prominent individual can present a warning sign.

## VERIFYING CLIENT INFORMATION

Against this background, it is a challenge for banks to obtain independent and credible verification of customers. A range of data sources exist and the volume of public information accessible via the internet is growing exponentially. There are verifiable and useful sources of information from corporate registries, commercial research and data providers. Banks will need to consider the legitimacy of information obtained from the internet, and carefully assess what is credible and relevant to the subject of their enquiries. When appropriate they should not hesitate to conduct detailed reviews of potential customers, from on-the-ground information sources.

## ORGANISING YOUR DEFENCES

As money laundering methods are becoming more sophisticated, firms (first and second line staff) will need to take rigorous steps to mitigate the risks of doing business with 'persons' from these regions/countries. These include:

- identifying any Russian and Eastern European Politically Exposed Persons, their connections and other high risk customers amongst the existing customer base as a priority, checking whether adequate enhanced due diligence has been undertaken on all high risk customers. In particular this involves establishing source of wealth, checking for adverse media and obtaining senior management approval for account opening and continuance of the customer relationship
- reviewing management information about new customers to determine if there has been an increase in the number of new customers from Russia and Eastern Europe. If this is the case, seek an understanding as to why this has happened. For instance, is your front office actively targeting this population?
- reviewing whether reporting of new and existing client domiciles/nationalities is provided to the executive committee and/or board. Does business from these jurisdictions fall within your bank's risk appetite?
- examining transactions to determine if there are any payment trends (e.g. funds originating from Eastern Europe remitted to the UK via circuitous routes or vice versa)
- considering staff refresher training covering the due diligence requirements / background of anti-money laundering and regulatory consequences
- devising a plan of action to resolve any deficiencies or omissions on any of the above, including remediating any lack of due diligence information.

THERE ARE HURDLES TO BE OVERCOME  
WHEN REMITTING FUNDS TO THE UK, PARTICULARLY  
AS ANTI-MONEY LAUNDERING CHECKS HAVE  
BECOME FAR MORE STRINGENT IN RECENT YEARS  
AND ARE NO LONGER PERCEIVED TO BE MERELY  
A TICK-BOX EXERCISE.

### UNDERSTANDING THE RISKS

Your bank's board and senior executives need to understand the increased risks and requirements which arise from doing business with 'persons' from Russia and Eastern Europe.

As MLRO you need to be confident that your bank has the right systems and controls in place to mitigate those risks and that appropriate reporting is provided. Decisions and processes should also be evidenced robustly.

Failure to address these issues means the financial sector, and especially MLROs, will continue to fall foul of anti-money laundering regulations and put their firms' reputations at risk.

Fortunately for Mrs Jardine and her former employer, the Jersey Court acquitted them of the charges brought by the prosecuting authorities. Her defence successfully argued that Mrs Jardine, by undertaking a risk assessment, had taken into account the information available to her and had considered whether or not there was a risk of money laundering. She concluded there was no money laundering but only an unresolved question about the source of funds received by her employer. The verdict in AG v Jardine suggests that PEP status does not automatically give rise to a suspicion of money laundering provided a risk-based assessment is carried out.

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**Andrew Jackson** is a Director in FTI Consulting's Forensic & Litigation Consulting practice in London.

### MITIGATING THE RISKS

Identify Russian and Eastern European PEPs in your customer base

Determine increases in new customers from the region

Examine transactions for any payment trends

Plan to resolve deficiencies or omissions on any of the above



# Informed Investors can Prosper in Africa

FTI Consulting's Strategy Consulting & Research team surveyed opinion leaders ahead of the 2015 World Economic Forum, held in June in South Africa. The overwhelming majority were upbeat about the investment prospects for the continent in the near term, even though half continue to view Africa as a risky investment destination.



FTI Consulting's survey of opinion leaders who attended the WEF in Nigeria in 2014 and are planning to attend the South Africa conference this year identified East and West Africa as the most promising regions for investors. They see telecommunications and infrastructure projects as likely to be the most valuable investment targets. A majority also expect an increase in M&A activity.

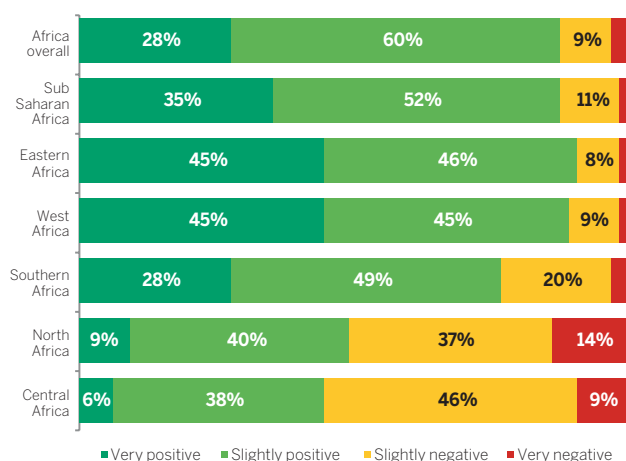
At the same time, both business leaders and African governments have work to do to make the continent more attractive to investors. Respondents said businesses need to become more effective communicators and African governments should be more realistic about what investments can achieve.

### A MORE BULLISH OUTLOOK, WITH SOME CAVEATS

Opinion leaders take an overwhelmingly upbeat view of the investment prospects for Africa, with 88 percent expressing optimism about the continent's investment outlook for the next 12 months (Graph 1). Majorities of those surveyed were positive about the prospects for every region of the continent with the exception of North Africa and Central Africa, where only 49 percent and 45 percent, respectively, were bullish about investment activity over the next year.

### Outlook for Investment Activity across Africa Graph 1

Q. What is your general outlook for investment activity in the following locations over the next 12 months?



88% of investors are upbeat about investment outlook for next 12 months, according to new research released by FTI Consulting.

To be sure, given the scale of challenges facing the continent and the inherent geopolitical and economic dangers, seven out of ten respondents remain cautious about making an unequivocal commitment to Africa, a number that has changed little from 2014. Nearly half of those surveyed (49 percent) said they view business opportunities on the continent as "important but risky", down only slightly from the 52 percent who gave a similar answer last year. Just a third of respondents see Africa as essential to strategic growth, up from 30 percent in 2014, while the remainder say they are watching developments, but remaining on the sidelines for now, similar to a year ago.

### COMMUNICATIONS, INFRASTRUCTURE AND M&A LEAD THE WAY

While close to 90 percent of the opinion leaders FTI Consulting surveyed see an increase in all categories of investment in Africa over the next 12 months (Graph 2), respondents are most bullish about a rise in investment projects relating to next generation communications, such as fibre and mobile broadband networks (96 percent) and traditional infrastructure, such as transport, energy, schools and hospitals (90 percent).

When asked where they would most like to see increased investment, however, the largest number of respondents opted for agriculture and farming (74 percent, up from 60 percent in 2014), followed by energy and utilities (67 percent) and transportation and logistics (61 percent).

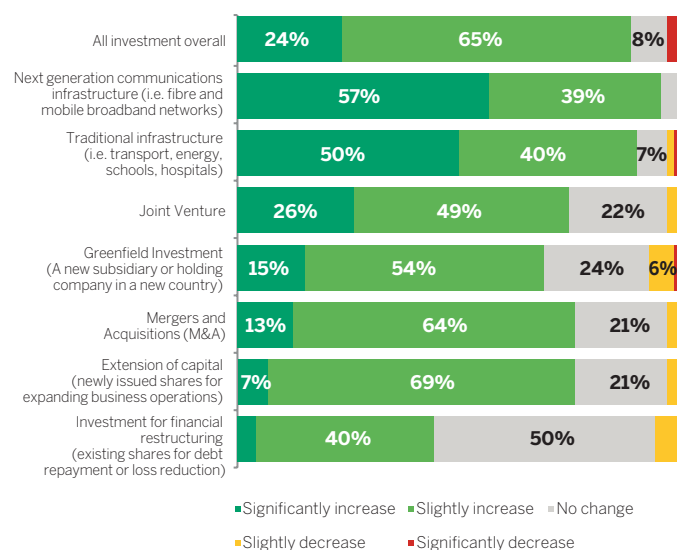


More than three-quarters of those surveyed (76 percent) expect an uptick in mergers and acquisitions in Africa. Although an identical percentage thinks this increase in the transaction pipeline is most likely to come from multinationals outside Africa, half of respondents expect a large proportion of deals to be intra-African in origin.

## Investment into Africa

### Graph 2

Q. Which of the following types of investment into Africa is expected to change over the next 12 months?



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As already noted, opinion leaders were optimistic about the outlook for most parts of Africa to benefit from increased investment, with East Africa (91 percent) and West Africa (89 percent) perceived as having the best prospects. When asked to name individual countries that are likely to act as gateways for investment in Africa within the next five years, majorities of respondents clearly identified three of the continent's fastest growing economies: Nigeria (76 percent), South Africa (60 percent) and Kenya (56 percent).

## BUSINESS HAS A ROLE TO PLAY IN IMPROVING THE INVESTMENT CLIMATE...

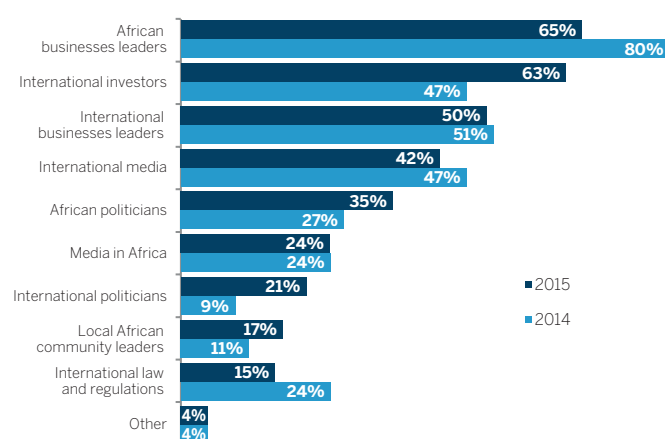
While investors see strong opportunities to increase investment in Africa, the high levels of respondents sounding a note of caution suggests that there is significant room to improve the investment climate on the continent. In particular, opinion leaders believe that business leaders need to become more effective communicators and that African governments need to both provide greater support and be more realistic about what investment can achieve.

Respondents' views about which groups are most effective at encouraging investment in Africa are evolving. Nearly two-thirds (65 percent) still say African business leaders are the most effective at attracting the investment needed to boost their economies, down from 80 percent in 2014 (Graph 3), compared with just 35 percent who are similarly confident about the ability of African politicians to help attract investment. Meanwhile, the number seeing international investors as the most able has risen to 63 percent from 47 percent a year ago.

## Encouraging Investment into Africa

### Graph 3

Q. To the best of your knowledge, which of the following groups are particularly effective at encouraging the right sort of investment into Africa to help boost the economy and benefit to society?



At the same time, six out of ten survey respondents believe businesses aren't adequately communicating their contribution to economic stability and development, nor are they conveying the importance of greater transparency in legal systems and tax and royalty payments to governments. Similar numbers agree that business leaders could do more to emphasize the importance of government spending in areas that will help lift living standards. Seven out of ten of

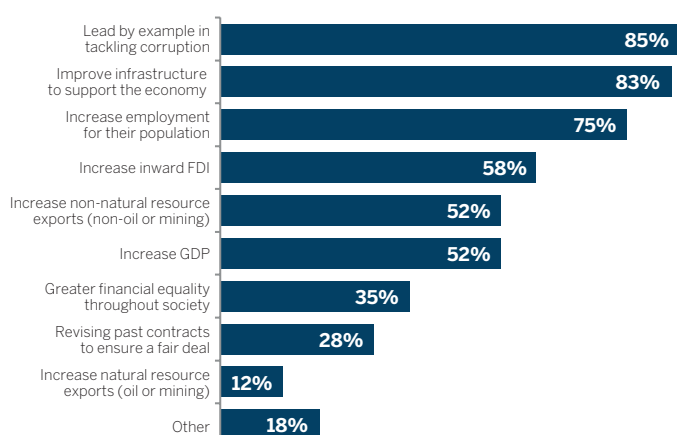
those surveyed also believe companies operating in Africa should make local engagement a greater priority.

Opinion leaders are also apparently re-evaluating some of their own views on investment in Africa, with 76 percent now agreeing that the court of public opinion has influence over how businesses operate on the continent, up from 62 percent in 2014 (Graph 4), even while the number of those agreeing that natural resources are a birthright for all of a country's citizens to benefit from has fallen to 81 percent from 93 percent.

### Opinions on Natural Resources & Influence of Public Opinion

Graph 4

Q. How strongly do you agree or disagree with the following statements?



### BUT GOVERNMENTS WILL NEED TO DO THEIR PART

Survey respondents also have identified a number of ways in which they believe governments themselves could create a more favourable business environment, with nine out of ten highlighting government support for investment and 96 percent citing better availability of public-private partnership opportunities as two of the most critical areas. When it comes to government policies, opinion leaders say the most important areas for African leaders to concentrate on are tackling corruption (85 percent), improving infrastructure (83 percent) and increasing employment for their populations (75 percent) (Graph 5).

Meanwhile, nearly three-quarters (74 percent) of those surveyed say host government expectations of investment can be unreasonable, although this number has fallen slightly from 79 percent in 2014. More than nine in ten say these expectations and those of local communities help contribute to tension among stakeholders and complicate the process of doing business in Africa.

Perhaps as a result, the number of respondents expecting an increase in the amount of contract arbitration between governments in Africa and private enterprises over the next year is unchanged from 2014 at 56 percent. A willingness on the part of governments to work more closely with business leaders could help mitigate disputes earlier on.

### Focus Areas for Leaders of African Countries

Graph 5

Q. Which of the following do you consider is particularly important for leaders of African countries to concentrate on?



### SUMMARY

Although opinion leaders continue to place a high value on business opportunities in Africa, those responding to the FTI Consulting survey clearly see further work to be done in making the continent a comfortable and attractive investment destination.

A greater willingness on the part of business leaders to make a better case for the value of their investments will be one key element of this process. Yet, greater cooperation between business and government leaders, and stronger support for investors from local leaders on the ground can help bring all stakeholders on board and improve the flow of investment.

This research was conducted online by the Strategy Consulting & Research team at FTI Consulting from 15th to 20th May 2015, involving n=78 opinion leaders on Africa attending the World Economic Forum, South Africa in June 2015. For more information on the research methodology: [market-research@fticonsulting.com](mailto:market-research@fticonsulting.com)

Please note that the standard convention for rounding has been applied and consequently some totals do not add up to 100%.

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# 100 Days of Active Ownership: **The Key to Success**

The early days following a change of ownership or restructuring are vital when it comes to preserving or enhancing the value of a business. Michael Vivian explained how a 100-day plan can be used by advisors as a key tool to galvanise a team, prioritise actions and drive quick wins.





The most important thing is to make sure the firm is delivering change every single day. Speed is of the essence, not only for companies facing insolvency, but also for a company which has been taken over by private equity owners in a vanilla acquisition.

Therefore in the first 100 days the new owner needs to take control, get “under the bonnet” and develop a granular view of the plan developed during the investment case. Put simply, quickly set the energy and reinforce the daily tempo from the top down.

Plans should focus around three main areas: cash, change and communication. In more stressed acquisitions, cash is inevitably the first area of focus, to ensure that the business has a stable platform to build from. Underperforming companies frequently prioritise revenue growth targets, but quickly need to switch their mindset towards cash and profit. In more difficult engagements this may involve detailed 13-week cash forecasting. In others there may be a more strategic piece of working capital improvement.

Implementation of rapid change is also essential in a 100-day plan. The plan may involve delivering quick wins identified prior to acquisition, or quickly developing a deep understanding of the processes or systems which must change. In either case, the key is getting the right people focused on the task.

Some people thrive in a high-change environment – they are intuitive thinkers who can work with imperfect data. Part of the skill of 100-day planning is finding leaders who inspire and drive change, and then co-ordinating their energy.”

Finally, one of the trickiest yet most important elements of the plan is communication. It is essential to multiply the efforts of the project team, so everyone is pulling in the same direction and buys into the turnaround efforts. Prior to deal completion, typically only senior management are actively involved, and the majority of the team may have experienced the exhaustion of “deal fatigue”, or at least feel uncertain of

the future and therefore become disengaged. Experience shows that the best communication style is inclusive but very honest – even if there are tough messages – to get people on board and willing to be part of the change.

Communication is also about getting the right information to the right decision-makers. One of the first things FTI Consulting ensures is that the company’s reporting and management information is fit for purpose and drives action. Underperforming companies often have too little information hidden in too much data. The skill lies in identifying the key levers for rapid improvement.

Ultimately, 100-day plans are used to establish stability, speed and to create the platform for the business to move forward successfully.

**Michael Vivian** is a Managing Director in FTI Consulting’s Corporate Finance practice in London.

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# Rail Projects: **Right on Track**

Capital Expenditure on rail projects in the Gulf Cooperation Council (GCC) countries is forecast to be in excess of USD\$200 billion over the forthcoming years. All six of the GCC Member States have mega projects either under construction or in the planning phase and, per capita, the GCC is undergoing one of the biggest infrastructure spends in the world.

Yet for the majority of these countries rail is a new mode of transport and, as Mike Jones explained in June, this brings with it financial, regulatory and cultural challenges which must be addressed.





Rail projects in the GCC States aim to satisfy both regional and local demands. Growth in the economies and populations of the GCC States since 2000 has led to an increase in interstate trade and movement of labour. This has placed a great strain on air, sea and land transport systems, despite massive investment in all three. Rail is seen as providing a viable and more environmentally friendly alternative for the movement of freight and passengers between states.

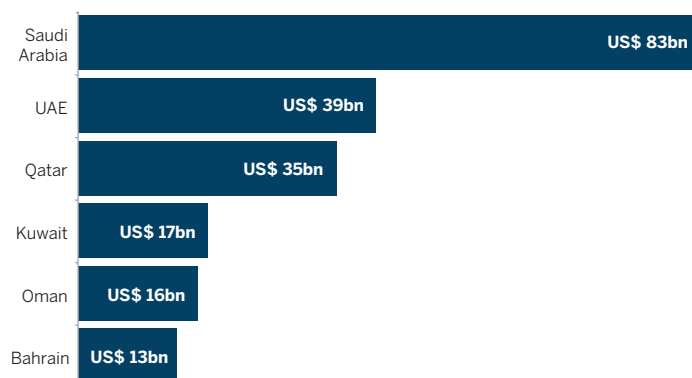
At a local level, as workers flocked to urban conurbations where trade is concentrated, traffic jams soon followed with an increase in road accidents. Today, certain GCC States have some of the highest road accident fatality rates in the world. Urban rail schemes were identified as being able to ease congestion and reduce accident rates.

### THE PROJECTS

There are a range of rail projects planned in the GCC: from high-speed passenger systems to long distance freight lines; from nationwide networks to urban light rail systems. Even the world's first hydrogen-powered tram system has been recently announced in Dubai. It is not a case of one state competing with another; there is a genuine desire to have a regional transport solution. Back in 2006, the GCC Technical Committee decided to build a rail network that would connect the GCC States. Running from Oman to Kuwait, the railway will pass through United Arab Emirates (UAE), Qatar and Saudi Arabia. This GCC railway network will have 2,177km of track with an estimated cost of USD\$25 billion.

The UAE is steaming ahead with the development of its part of the GCC network, with Saudi Arabia and Oman also progressing their contributions to the system. Saudi Arabia and the UAE say that they are still on track to meet their 2018 targets; however, difficulties with tendering and procurement in other countries could delay their planned completion date to 2020.

### GCC Mega Rail Projects



PER CAPITA, THE GULF COOPERATION COUNCIL IS UNDERGOING ONE OF THE BIGGEST INFRASTRUCTURE SPENDS IN THE WORLD.

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In terms of overall expenditure on rail, Saudi Arabia far exceeds all of its neighbours. Its passenger projects include the Haramain High Speed Phases 1 and 2, Riyadh Metro (USD\$22.5 billion) and Jeddah Light Rail. Saudi also has two mega rail-freight projects: Landbridge Railway (USD\$7 billion), a 950km line connecting Jeddah on the Red Sea with Dammam city on the Arabian Gulf; and North-South Railway (USD\$3.5 billion), a 2,400km line connecting the bauxite and phosphate mines at Az Zubairah and Al Jalamid to processing facilities at Ras Azur Port.

More recently, the Kingdom announced a further USD\$23 billion worth of rail and metro projects. Forming part of the country's national transportation expansion programme, the projects are open to public-private partnerships. The announcement follows the Saudi Arabian General Investment Authority's (SAGIA) renewed efforts to increase foreign investment to the Kingdom by streamlining the ease of doing business and introducing an investment fast-track programme focusing on key sectors such as transportation.

In the UAE, the RTA has successfully completed its first metro and tramlines in Dubai and announced it will build a new metro line to the Expo 2020 site. Abu Dhabi plans to develop a metro system and to facilitate a high-speed link from Abu Dhabi city to Dubai city. Etihad Rail is developing the UAE national network and DB International, a subsidiary of Germany's national railway, is in a joint venture with Etihad Rail for operation of the network. In June 2015, it was announced that Etihad Rail dropped the Oman link from the retendered second phase of the network, but it is not yet clear whether the drop in oil prices or another reason is behind this.

As Qatar prepares for the FIFA Football World Cup in 2022, there are plans to have a new rail system that will serve all 12 of the World Cup venues. Qatar has allocated USD\$35 billion for rail projects that include its 212km four-line Doha metro system. Qatar Rail's QIRP: Passenger and Freight Rail phases worth an estimated USD\$18 billion are expected to be awarded this year.

Oman also has ambitious plans. It has already completed its feasibility and route alignment studies for an estimated USD\$15.5 billion national network and recently awarded the contract for the project management services with preliminary designs under preparation. It is also seeking an operating partner, which it intends to appoint later this year. The estimated total length of the Oman National railway network is 2,135km. It is divided into several segments, linking Oman's borders with the UAE to Muscat, as part of the GCC railway network and also to the southern parts of the country.

Finally, Bahrain and Kuwait are keen not to be left behind. In addition to playing their part in the GCC railway network, they also have public transport plans of their own, including light rail, monorail and tram networks.

Other surprise investors in the region include Iraq, which has plans to invest USD\$70 billion in its new railway network, part of which will connect to Iran via the Basra-Shalamchah railway. In Lebanon, feasibility studies are currently underway to rejuvenate its railway network, which dates back to the late 19th century, operational until the Civil War in 1997 and since remaining derelict.

WHILE THERE REMAIN MANY CHALLENGES,  
THE DETERMINATION OF THE MIDDLE EASTERN  
STATES TO BUILD THESE NETWORKS WILL ENSURE  
THAT RAIL BECOMES A VITAL PART OF THE  
REGION'S INFRASTRUCTURE.

### THE CHALLENGES

While the drivers for rail projects in the GCC are clear, there remain many challenges. Technical challenges of dealing with harsh environmental conditions can be overcome: there had been a rail network in Saudi Arabia for 60 years. Securing finances for the large mega projects can be more challenging. For example, Saudi Arabia's Landbridge was envisaged as a private finance initiative using a 50-year Design, Build, Operate, Maintain (DBOM) concession but the preferred bidder failed to reach financial close. It will now be funded by the Public Investment Fund of the Saudi Government. It remains to be seen whether the recent slump in oil prices will affect the development of rail schemes across the region.

For passenger rail systems, there can be cultural challenges. In a survey commissioned by Abu Dhabi's Department of Transport, many Emirati respondents were concerned about mixed-sex carriages. In particular, young Arab women were afraid of crime and harassment on crowded carriages. The Dubai Metro has sought to address these issues by having a women and children only section on each train. Whether such measures will be sufficient to tempt passengers out of the security of their 4x4s remains to be seen.

Planned and current investment in rail in the Middle East is underpinned by fundamentals of young and rising populations, economic growth and an increase in interstate trade. Furthermore, projects such as the GCC railway network will unite the GCC region and other countries in the Middle East. Rail provides a solution to a transport need that is capable of enhancing quality of life. While there remain many challenges, the determination of the Middle Eastern states to build these networks will ensure that rail becomes a vital part of the region's infrastructure.

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## Successful M&A: **It's about more than just price**

The summer of 2015 saw a surge in mergers and acquisitions activity in many key markets across the world. As Ed Bridges and James Melville-Ross wrote, large multi-nationals need to consider communications issues as well as financial and market dynamics to make their deals succeed, as some private equity houses have already discovered.



“Sell in May and go away,” it used to be said. This summer, though, the markets have been gripped by some of the noisiest and highest value M&A activity for a long time with Shire making a surprise, hostile bid for its US rare disease rival Baxalta, Zurich acquiring RSA and Monsanto withdrawing from the takeover of Syngenta.

As confidence returns to the markets we'll probably see more of these large deals. Meanwhile, private equity will also be very active over the next few years, especially in Europe where PE funds are about to enter a new fundraising cycle as 2007-2013 vintage deals move into exit mode.

Recent reports on global M&A reveal a surge of activity from Asia into Europe. There will also be a lot of US to Europe activity thanks to some unique arbitrage opportunities, faster growth in the US than in Europe and the highly liquid global debt markets. In particular we believe that Life Sciences as well as Technology, Media and Telecoms are white hot and Financial Services will move into a consolidation cycle again.

THE SUMS MIGHT ADD UP AND THE MARKETS MIGHT APPROVE OF THE STRATEGY AND THE PRICE BUT, IGNORED OR HANDLED BADLY, IT'S POOR COMMUNICATION THAT CAN TRIP UP A MULTI-BILLION DOLLAR DEAL.

### MORE THAN JUST PRICE

But a successful cross border acquisition is about more than price, synergies and growing market share. International M&A is successful when it takes into account communication and cultural issues. The sums might add up and the markets might approve of the strategy and the price but, ignored or handled badly, it's poor communication that can trip up a multi-billion dollar deal.

This is especially important for companies seeking to make acquisitions in mature markets like the UK and Europe, where M&A is more likely to be associated with cost reduction and, ultimately, job losses than it is in Asia. Often, when we're advising US companies on inward investment into Europe we surprisingly find ourselves having to advise them about cultural sensitivities to ensure that they're not seen as being red in tooth and claw.

Similarly Asian buyers have to understand how the European media works and how to interact with it. Chinese and Japanese journalists tend to take their line from the management of a company. US journalists are also often more business friendly, whereas European and, especially British journalists, are far more sceptical. Communicating with them and managing media coverage requires a whole new mind-set for Asian business leaders.

If you're a business from Asia you also need to show that you're committed to the company you're buying and that you're taking a hands-on role rather than sitting silently on the other side of the world. Communicating effectively with a business and its regulators in another country, let alone one that's situated in another continent, requires more than just a translator.

## EUROPEAN CONSIDERATIONS

Companies from the US and Asia who are buying pan-European businesses have to learn how to relate to the management and workforce in each individual EU state in which that business operates as well as the supra-national EU authorities. As any European knows, the cultural differences as well as laws and regulations still vary greatly between say, France and the UK or between Greece and Germany.

Individual governments in Europe often have “national champions,” that they do not want to see go to a foreign buyer – whatever the takeover laws might say. Employment law and other regulations are highly fragmented and non-European business leaders and their advisors need to be aware of this during the initial phase of negotiations. Trying to repair fractured industrial relations or simply soothe hurt feelings can be protracted, costly and embarrassing. Although pan-EU integration and standardisation have developed over the last few years, it’s important to remember that politicians and officials working in Brussels are still very much aware of their own national interests and loyalties. This lack of uniformity even at the heart of the EU requires non-European companies to approach deals with the right knowledge and insights.

As an example, let’s look back to 2013 when Microsoft bought the devices and services business of Nokia for €5.4billion, one that led to the transfer of more than 32,000 employees to Microsoft. For three weeks ahead of the deal’s announcement, a team of eight FTI Strategic Communications specialists including sector PR and public affairs experts, employee engagement specialists, creative colleagues, social media professionals and in-house presentation trainers were mandated with helping Nokia and its senior leadership team prepare for the task of communicating this great change.

The team helped communicate to 100,000 employees and over 200,000 resellers, taking into account cultural differences and the requirements of Brussels regulators and the Finnish government as well as delivering key messages to media, political and internal audiences across six continents through multiple communications channels. Not all buyers would have been able to successfully achieve this without local market support.

Interestingly, PE, sometimes maligned for its macho approach to deals has, to a large extent, learnt this lesson. When US PE firms began to acquire UK and European firms

## HAVING THE RIGHT COMMUNICATION SKILLS CAN BE AS IMPORTANT AS GETTING THE COMMERCIALS AND THE PRICE RIGHT.

in the mid to late 1990s they tended to transplant teams from the US to Europe wholesale but, when they realised that they weren’t getting the volumes of deals that they were hoping for, a number of the big houses began to review that strategy.

They realised something that the market more generally needs to understand: when it comes to accessing management teams and boards, and making an acquisition that runs smoothly and creates value - having the right communication skills can be as important as getting the commercials and the price right.

### H1 2015 M&A FACTS

Cross-border deals:

**\$635bn**

European inbound deals:

**\$160bn**

Asia to Europe deals:

**\$48bn**

(second highest half-year on record)

- Source Mergermarket

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# Too Early to Celebrate? **Winning the Debate on Shale Gas Exploration in the UK**

While government announcements of oil and gas licences rarely make front page news, the award of the first set of 14th round onshore exploration licences in the UK in the summer of 2015 was different. As Seán Galvin and Phil Kennedy explained, one emotive word guaranteed the media interest: fracking.



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Years of controversy and debate have seen this simple industry shorthand for the tried and tested technique of hydraulic fracturing become a term of abuse and a gift to headline writers. Small wonder that celebrations among the successful bidders for these licences are likely to be muted. While one or two may have a new tactic to deploy, more in hope than expectation, most will be dreading the imminent battle for planning consent. Conventional community engagement, it seems, does not work when it comes to unconventional gas.

#### **BUT DOES IT HAVE TO BE THIS WAY?**

There's a high expectation that appeals against refusal of planning consent will be successful given national policy support for fracking – and any successful appeal will ease the passage of subsequent planning applications. But no operator receiving a licence in August 2015 will want to wait until late autumn 2016, at the earliest, to get on site. Or to have decisions imposed on communities rather than reached through local consensus.

So why does this appear to be such an insuperable problem? Fracking is a well-established technology, developed over several decades. There are precedents for safe, efficient and successful operations overseas. And despite the lurid headlines, polling in the UK shows as many supporters as opponents.

National government has the confidence to champion fracking. Even at a local level there are politicians willing to vote in favour of proposals.

The battle ought to be winnable.

FRACKING IS A WELL-ESTABLISHED TECHNOLOGY, DEVELOPED OVER SEVERAL DECADES. THERE ARE PRECEDENTS FOR SAFE, EFFICIENT AND SUCCESSFUL OPERATIONS OVERSEAS. AND DESPITE THE LURID HEADLINES, POLLING IN THE UK SHOWS AS MANY SUPPORTERS AS OPPONENTS.

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## ADVOCACY AND EDUCATION

Advocates for the onshore oil and gas industry in the UK are busy responding, commenting and welcoming. It's a worthy but reactive approach that leaves the industry too often on the back foot while others set the agenda.

No matter how much time operators put into communicating locally – and their efforts have been extensive – sceptics will remain unconvinced while they hear a different story from the national media. FTI Consulting's considerable experience running shale gas advocacy initiatives, such as Energy in Depth in the US, the Energy Resource Information Centre in Australia and Shale Gas Europe, tells us that a more proactive campaign is needed in the UK at both national and local levels to champion the technology and its potential contribution to our energy security.

Too much media reporting appears based on an assumption that the public opposes shale gas extraction. A survey conducted in 2014 by FTI's in-house research team found a far more balanced picture in the UK:

How favourable or unfavourable are you of 'fracking'?	
Very favourable	11%
Slightly favourable	29%
Slightly unfavourable	20%
Very unfavourable	17%
Don't know	22%

How aware and knowledgeable are you about the process called 'fracking' (also known as 'shale gas extraction' and 'hydraulic fracturing')?	
I am not aware of it	15%
I am aware, but not knowledgeable	61%
I am knowledgeable of it	24%

(Research was conducted online in April 2014 with 1,139 adults aged 18 years and over and reflective of the general population in terms of age, gender and location.)

The First Interim Report by the Task Force on Shale Gas, published in March 2015, noted declining public support for shale gas extraction, but a consistently even split between supporters and opponents. DECC's August 2015 Public Attitudes Tracker reported that 21% of respondents support the extraction of shale gas, compared to 29% in March 2014 – a proportion generally equivalent to those who oppose (28% in August 2015, and 22% in March 2014).

This balance of opinion is rarely evident from media coverage and the suspicion must be that many journalists covering the issue and local politicians making decisions are either unaware of the levels of silent support or simply choose to ignore it.

For the industry, these results show something significant: half the population is undecided. But the more their awareness is raised by industry opponents, the more likely they are to oppose. In other words, reacting isn't enough. The industry needs to tell its story with more confidence and vigour. Organised opposition has vowed to galvanise public opinion in their favour while the industry awaits the outcome of current planning appeals. The significant number of 'undecideds' are as much potential supporters as potential opponents, but for how long?

## UNDERSTANDING OPPOSITION

Given the current balance of opinion on the principle of shale gas extraction, why should there be so much opposition around individual proposals?

One mundane but significant factor that unites opposition to new development – whether to housing, supermarkets or even schools – is an objection to the additional traffic that it generates. Traffic doesn't just mean fears of noise, pollution and road safety; as an everyday issue, it means being unable to leave your driveway or being stuck at a busy junction. Those who object know that their own vehicles are part of the problem, but they are not embarrassed to say, "So far and no further."

Operators must start their local engagement with convincing answers on access to the drilling site, likely traffic levels and plans for managing movements to and from the site.

## A COMMUNITY STAKE

Whatever the level of support, it would be a surprise to see the forest of hand-painted pro-industry "Frack now!" banners that occasionally greets news cameras in the US, where FTI has been advising operators since the very start of the shale gas 'revolution'.

The source of this level of enthusiasm is arguably the direct and indirect economic benefits that individual landowners and communities in the US stand to make when development takes place, such as compensation, royalties and employment.

## WHAT THE DEBATE NEEDS RIGHT NOW, FROM BOTH SIDES, IS LESS HEAT AND MORE LIGHT. LESS LECTURING AND MORE LISTENING.

Emulating this continuing economic interest is the holy grail for economists advising the UK onshore energy industry. The majority of operators have already committed to providing £100,000 in community benefits per well-site where fracking takes place and a further 1% of revenues at the production stage. Some operators are promising hundreds of thousands of pounds in funds for charitable, educational or benevolent causes. The Government has proposed a sovereign wealth fund from shale gas revenues for the North of England, but it will not necessarily be spent in the locality of drilling operations.

There is a growing suspicion that one-off grants are too easily spent and forgotten, portrayed as bribes or interpreted as compensation for some unspecified damage. Energy specialists in FTI's Economic Consulting division are modelling alternatives and have been developing innovative models where meaningful ownership stakes might be offered to local communities through mechanisms such as crowd funding and shares in Community Interest Companies, to promote more sustainable local participation and benefits sharing.

Neither should the industry ignore the genuine quality of life concerns that many objectors express. While giving communities a real financial stake in their activities is desirable, operators must also demonstrate their own commitment to the well-being of the communities impacted by their presence.

### WINNING THE UNDECIDEDS AND THE DEBATE

For licences to become producing assets, a new approach is needed in the UK:

- A more proactive advocacy and education campaign, led by the industry.
- Specifically, education for local politicians and their advisors on technical issues.
- Robust media relations that challenge one-sided reporting.
- Mobilisation of supporters to encourage a more balanced discussion.
- A greater willingness by operators to address common concerns about traffic, monitoring and quality of life.
- Real incentives for the community that give them a meaningful stake in the project.

Industry advocates are quite rightly passionate about what they do and the wider benefits that shale gas development will bring to the UK. But we must not allow this enthusiasm to close our ears to what local communities are telling us. What the debate needs right now, from both sides, is less heat and more light. Less lecturing and more listening.

Success will require a timely combination of politics, economics, education and communication, along with a keen understanding of public attitudes. Only then will shale gas development move from the front page to the business pages and the industry be able, at long last, to realise the significant benefits that it offers to the nation's energy security.

**Seán Galvin and Phil Kennedy** are Managing Directors and energy and consultation specialists respectively in FTI Consulting's Strategic Communications practice in London.



# The Evolution of the FCPA: **Successfully navigating the Japanese-African Business environment**

In September the US Securities and Exchange Commission (SEC) announced that the Japanese conglomerate Hitachi had been charged with violating the Foreign Corrupt Practices Act (FCPA).

In this article, Philippa Symington and Pamela Wadi looked at Japan's growing influence in Africa and the potential risks it faces against a background of tougher anti-corruption enforcement.



As a result of the investigation, Hitachi agreed to pay USD 19 million to settle the SEC charges which included the inaccurate recording of improper payments made to South Africa's ruling political party, the African National Congress (ANC).

## UNDERLYING FCPA TRENDS

On the face of it Hitachi's FCPA violation is nothing new; foreign company with poor internal controls pays politically-connected intermediary to secure contract. According to the SEC's press release, Hitachi sold a 25% interest in its South African subsidiary to Chancellor House Holdings (Pty) Ltd., a company whose ultimate shareholding was held by the ANC. This allowed profits from power station contracts secured by Hitachi – using Chancellor House's political influence – to be shared with the ANC backed company. Hitachi also paid a USD 1 million 'success fee' to Chancellor House which was inaccurately recorded in the company's accounts as consulting fees. Despite the familiar pattern, both the nature and target of this SEC investigation indicates a changing regulatory focus.

The last ten years have seen a striking shift in tone from the US regulators who have adopted a more aggressive posture with respect to enforcing the provisions of the FCPA. The US authorities continue to target bribery offences committed outside the US through the use of more stringent investigative tactics and increased cooperation with other enforcement agents worldwide.

The Hitachi case is illustrative of this new stance; often constrained by needing the relevant local governments to cooperate with them, on this occasion the SEC appears to have overcome the hurdle by enlisting the assistance of the African Development Bank's (AfDB) Integrity and Anti-Corruption Department.

Moreover, this matter indicates the broadening sectorial scope of US regulatory interest. Previous FCPA enforcement actions have fallen within the oil and gas industry with the majority arising from West Africa; the Hitachi case is a first for South Africa and falls outside the extractive sector. Given that Japanese companies are increasingly involved across Africa, this change also represents heightened risks for their regional operations.

## GROWING JAPANESE FDI

Japan is one of the world's leading economies and whilst its progress into Africa has been slow, the country has made remarkable inroads expanding its presence and influence. In 2014, the Japanese government promised USD 32 billion financial assistance to resource-rich African nations as part of its bid to cement relations with the continent. Japan recently signed a bilateral agreement with Mozambique - the first such agreement it has entered into with a sub-Saharan African country – and similar investment frameworks are in the process of being agreed with other African countries. These should all encourage more investment in the region.

This commitment to Africa is matched by Japanese companies. In September 2015, the AfDB and the government of Japan agreed a USD 300 million loan to support private sector business under a joint initiative named the Enhanced Private Sector Assistance (EPSA) for Africa. Several large trading entities, including Sumitomo and

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Sojitz, are active across the continent. Construction firms, such as Mitsubishi, Mitsui, and Hitachi, are also involved in various capacities in a number of infrastructure projects in Africa. According to Japan's South African embassy, in 2013 the number of private Japanese companies in South Africa increased to 115. Direct investment from Japan has also increased in the country, and its cumulative total as of 2012 reportedly exceeded USD 26 million.

Notwithstanding the above, the popularity of Africa as a high-growth market is pushing Japanese companies into riskier investment terrains at a time when anti-corruption enforcement and awareness is at an all-time high. Hitachi is not the first Japanese company to face the wrath of the US anti-corruption regulators; Bridgestone, JGC Corporation and Sojitz have all been charged with FCPA violations in Latin America, Nigeria and Bahrain respectively. But as Japanese companies develop their new market strategies and pursue more opportunities in Africa, it is important that they are cognizant of the regulatory risks.

JAPANESE COMPANIES  
SHOULD LOOK  
TO CONDUCT  
COMPREHENSIVE DUE  
DILIGENCE THAT GOES  
BEYOND REVIEWING  
FINANCIAL ACCOUNTS  
AND LITIGATION FILES  
TO INCLUDE A LESS  
TANGIBLE NARRATIVE.

## ESTABLISHING PROPER INTERNAL CONTROLS

International anti-bribery legislation including the FCPA and UK Bribery Act (UKBA) require companies to make independent assessments of the ultimate shareholders and beneficiaries of their potential partners. Specifically, partnering with public or political figures and using their position in order to gain a commercial advantage is considered an offence under these laws. In many African countries, information that may identify both the political affiliations of immediate third parties and also the ultimate shareholders or beneficiaries of a company is not easily accessible. As such, Japanese companies should look to conduct comprehensive due diligence that goes beyond reviewing financial accounts and litigation files to include a less tangible narrative, which provides the story behind the public records.

Once a local partner is identified, it is important to ensure the necessary skills and expertise are in evidence, and that any fees paid are proportionate to the services rendered. Further to engagement, internal controls should ensure that all payments made to third parties are properly documented and regularly audited.



## THE EVOLUTION OF THE FCPA: SUCCESSFULLY NAVIGATING THE JAPANESE-AFRICAN BUSINESS ENVIRONMENT

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Although Japan is a member of the OECD, commentators note that its enforcement of domestic corruption laws is weak and there is no criminal liability for corporations under local laws. This is reflected in its position in Transparency International's 2015 Exporting Corruption report; Japan ranked as having made 'little or no enforcement' in making bribery in foreign countries a crime for its companies and nationals.

Whilst it may not be immediately obvious why the Hitachi case would fall foul of US regulations, it is important to be aware of the wide territorial reach of the FCPA, UKBA and other anti-corruption legislation. Navigating the complex governance and regulatory environments is essential to international business and a particularly notable factor for Japanese firms establishing business in Africa.

**Philippa Symington** is a Managing Director and **Pamela Wadi** is a Director in FTI Consulting's Global Risk and Investigations practice in London.

# The European Commission Review of Telecommunications Regulation

In September, the European Commission is undertaking the first fundamental review of the telecommunications regulatory framework since 2009. Scott Morrison and Neil Clements reviewed this consultation and highlighted the importance of engagement on the key issues.





This initiative is driven by a range of significant structural changes identified by the Commission, including the continuing migration from copper to fibre access networks, fixed/mobile convergence, retail bundling and the emergence of over-the-top (OTT) services that are rapidly transforming the traditional telecommunications markets.

Since the liberalisation of EU telecommunications markets across the 1980-90s, economic regulation of the sector has focused on using regulation to open up markets, promote competition, free up economic bottlenecks and enable access to key inputs. More recently, there has been a trend towards less retail regulation with a focus on targeted wholesale regulation. However, whilst the sector and its investors are making the argument for the relaxation of regulation, it is not inconceivable that the Commission's review will lead to increases in the scope and depth of regulation of the European telecoms sector.

Critically, the review contemplates redefining communications services to include elements of social media and instant messaging, and considers the merit of imposing ex-ante regulation on these services. The Commission also suggests that increased regulation of retail markets might be appropriate, there is a real risk of both increased regulatory intervention, and a greater degree of uncertainty as to outcomes arising from lengthy interaction between the EC and member state regulators.

Network operators and their OTT counterparts would be well advised to engage early and effectively in the consultation process before it concludes in December.

### **DIGITAL SINGLE MARKET INITIATIVE**

As we highlighted in our recent paper 'Europe goes for telecom reform', in May 2015 the European Commission set out a roadmap towards a Digital Single Market (DSM). According to the EC, the DSM will deliver an environment in which "individuals and businesses can seamlessly access and exercise online activities under conditions of fair competition, and a high level of consumer and personal data protection, irrespective of their nationality or place of residence."

The Commission has diverse and ambitious objectives; amongst the 16 broad elements of the DSM roadmap is a review of the entire telecommunications regulatory framework. The current regulatory framework consists of the five Directives of the Telecoms Package, three Decisions relating to the regulation of spectrum, and four 'soft law EU recommendations'. Add the member state governments and the independent national sector regulatory authorities, and a complex web of regulation emerges. A comprehensive review and reform exercise is a significant undertaking.

ON ONE HAND, THE REVIEW QUESTIONS WHETHER THE CURRENT APPROACH OF EX-ANTE MARKET REVIEWS IS NEEDED AT ALL AND ON THE OTHER HAND QUESTIONS WHETHER EC GUIDANCE ON MARKET REVIEWS SHOULD BE MADE BINDING.



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## REVIEW OF THE TELECOMMUNICATIONS REGULATORY FRAMEWORK

The Commission's review of regulation is lengthy and complex; the questionnaire that has been issued on the current regulatory framework includes over 200 individual questions, covering a broad range of issues.

**Network access:** The review covers five different areas. The first of these is the regulation of network access – in particular the market reviews that regulators are required to undertake every three years. The review of network access has the scope to make fundamental changes, the Commission considers whether investment should be a primary policy objective of the regulatory framework, how to promote the migration from copper to fibre, and even whether copper should be decommissioned after 2020. On one hand, the review questions whether the current approach of ex-ante market reviews is needed at all and on the other hand questions whether EC guidance on market reviews should be made binding.

The review also considers that retail regulation might need to be strengthened in order to address market failures, and the Commission suggests that retail regulation might be incremental to existing wholesale regulation.

**Spectrum management:** The second area of the review covers Europe's approach to spectrum management, which is currently governed by a range of frameworks, decisions, and policy programmes. The Radio Spectrum Policy Programme dates from 2012 and was intended to harmonise strategic planning across Europe. The review questions suggest that the Commission is looking for even more harmonisation across Europe. This has fundamental implications for any network operator or investor considering cross-border consolidation.

IMPLICIT IN THIS SECTION  
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'LEVELLING UP' RATHER  
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THAT FACED BY THE OTTS.

### Redefining communications services for a new age:

Thirdly, the review considers existing sector-specific regulations. The existing regulatory framework only covers what the EU calls Electronic Communication Services (ECS) such as traditional voice and data services but excludes OTT services such as those provided by WhatsApp and Viber and by social media platforms such as Twitter and Facebook. This speaks to the debate about creating a 'level playing field' between the OTTs and traditional operators. Implicit in this section, however, is the possibility of a 'levelling up' whereby the OTTs could be subject to EU ex-ante regulation, rather than a 'levelling down' of the regulation of the traditional operators towards that faced by the OTTs.

The review also considers the possibility of including machine to machine (M2M) communications in the definition of communication services, which could have fundamental implications for the burgeoning 'Internet of things'. The second half of the section dives further into the detail and asks questions on number portability, switching regimes, three-digit harmonised numbers and 'must-carry' obligations.

**Universal Service Obligation (USO):** Sensibly given the transformation of consumer access to telecommunications services over the last ten years, the review then considers the scope of the USO in Europe. The review questions both the need for an ongoing USO regime, and whether the scope of the existing regime requires amendment.

The Commission considers whether a voice service is still required in light of developments in mobile telephony, suggesting that both VoIP and mobile might act as substitutes, but seeks reassurance that they can provide 'reliability, quality and security' on a par with fixed services. The Commission even considers whether coverage targets should move away from household coverage to individual coverage and implies that mobile services with coverage obligations might play a role in the USO. As well as redefining how the USO could be defined and delivered, the review contemplates extending the scope of the USO to include broadband access and then debates whether a broadband USO would be defined by speed, services, or by both. Finally, the Commission debates how USO services should be funded, suggesting a greater role for Europe in funding the USO.

**Institutional Framework:** The final part of the review considers the institutional set-up in Europe. In this section, the Commission considers whether a 'common EU approach' would be beneficial, and whether BEREC's role should be strengthened. The Commission notes that the design of access remedies is not consistent across Europe, suggesting possible harmonisation.

### FTI CONSULTING'S VIEW

The EC's review of the telecommunications framework is timely. The last fundamental review was undertaken back in 2009 before transformative developments such as digital switch over and the release of 4G spectrum. Coupled with the rollout of FTTx technologies, the rise of the smart phone and the advent of 'OTT' services, it is clear that the technical and commercial landscape has been transformed since 2009, and even more fundamentally since the regime was set up in the early 2000s.

Since liberalisation, economic regulation has focused on mitigating the impact on consumers of enduring economic bottlenecks such as access to the local loop. In this regard some major challenges remain; the implications for consumers of inadequate access to the internet-based society have never been greater, and the investment required to provide high quality access to 100% of the population is almost prohibitive.

However, the diversity of network access options, consumers' perceptions of the value of services provided, and the different business models that firms have developed to gain reward for the value they create have all fundamentally altered the commercial and technical landscape.

Indeed, the value chain that has developed around the broader internet ecosystem is radically different from the traditional linear telecommunications value chain of network owners, wholesalers, retailers and consumers. The new internet value chain, of which the telecommunications sector is now part, is far broader and more complex. Multi-sided markets have proliferated; the drivers of value and drivers of revenue have atomised and are now coalescing around a very different structure from that which existed when the telecoms regulatory regime was first envisaged.

The European Commission's review of the framework will have far reaching impacts for all participants in the internet value chain, not just the owners of the network infrastructure and those who seek access to it.

This review could result in far greater pan-EU harmonisation, giving more decision-making power to BEREC and consequently less discretion for national regulators. The effects of the European Commission's review may also be felt in countries outside the EU as other European countries and states in the rest of EMEA take heed from the EU.

The merits of centralised regulatory certainty versus member state -specific discretion will be a central debate as the new regulatory framework is developed.

Now is the time for firms throughout the internet ecosystem to engage with the EU's consultation process, to assess the potential impact on their business models and to provide theoretically rigorous and evidenced-based submissions that will influence the agenda effectively.

**Neil Clements** is a Managing Director and **Scott Morrison** is a Director in FTI Consulting's Economic & Financial Consulting practice in London.

# The EU Emission Trading System

2015 marked the tenth anniversary of the EU Emission Trading System (ETS). A decade down the line, it is clear that the system is not living up to its potential and in need of an overhaul, especially as work has already started on the post-2020 ETS that will implement the EU's 2030 climate targets.

In this article, FTI Consulting's experts in Brussels, London and Paris looked at the flaws of the current system, and the proposed fixes, as well as examining what the ETS could look like after 2020, and analysing its impact on emissions and business.





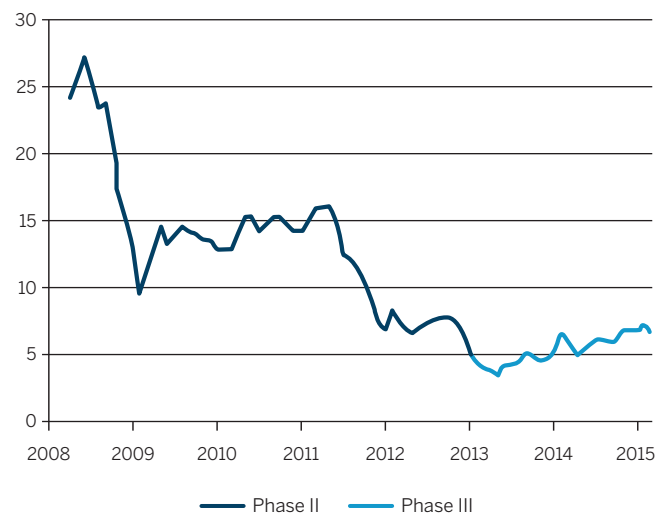
The ETS is one of the EU's major tools to tackle climate change. It is the world's largest emission trading system, encompassing more than 11,000 power stations and industrial facilities in 31 countries, as well as aviation emissions.

The main logic of the system is simple: by limiting (i.e. putting a cap on) emissions and allocating permits the EU creates a carbon market where emission allowances are traded. Prices are defined by supply and demand, whereby commercial entities that emit less than foreseen when they purchased their allowances can sell their allowances to those that emit more than is covered by their allowances. Companies that reduce their emissions would see a financial benefit from their low-carbon investments and could potentially even make money. Ultimately, the aim is to incentivise investment in low-carbon solutions without damaging EU competitiveness.

However, in recession Europe's economic output has declined. As a result demand for emission allowances decreased, the system became oversupplied and prices crashed from a peak of €30 per tonne in 2008 to around €7 per tonne at the end of February 2015. Other factors exacerbated the problem, such as the use of international offsets (emission reductions outside the EU that compensated for emissions within the EU) led to a lower demand of allowances. The system is now flooded with a surplus of permits.

The evidence is growing that the weak and volatile prices in the ETS are not effective in driving carbon emission abatement in the power sector. As a reference, the implied switching price between coal and gas fired generation ranges from 30 to 40€/tCO<sub>2</sub> with current gas and coal prices. In a longer term perspective, current ETS prices are also held to be well below the kind of carbon prices that are needed to make investment in clean technologies competitive.

**Figure 1: Carbon price (€/tCO<sub>2</sub> equivalent)**



Source: Bloomberg

Clearly, the system needs a structural reform. In what is referred to as backloading, the European Commission has already postponed the auction of 900 million allowances until 2019-2020. But this does not reduce the number of allowances, it simply delays their release.

### MARKET STABILITY RESERVE

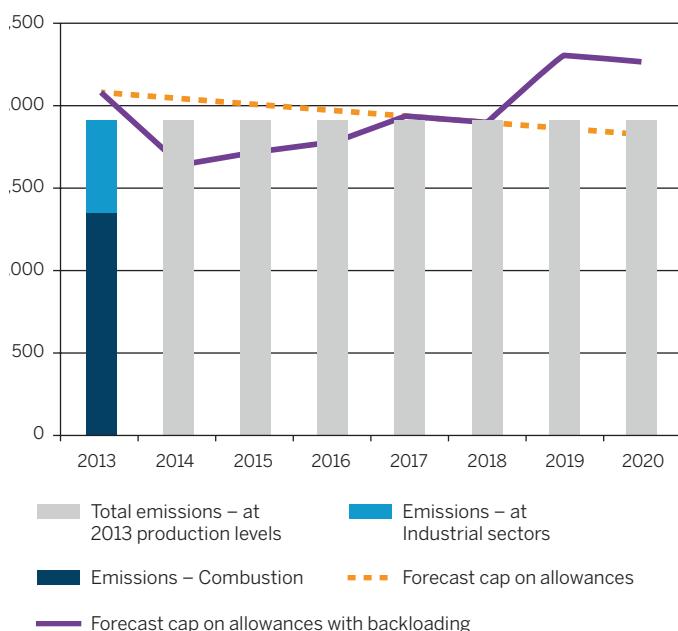
Market Stability Reserve (MSR) has been proposed as a solution to revive the ETS, make it more responsive to economic conditions and prevent extremes in supply of permits. The MSR would introduce a supply management mechanism by which the reserve would release 100m permits if the number available falls below 400m and remove 100m if the system is flooded (above 833m permits).

The main sticking point of the MSR is the start date. On 25 March 2015 Member States agreed a start date of 2021. But the European Parliament backs a 2019 start, and many MEPs favour an even earlier date. Finding agreement will be tough. Where Member States and MEPs are aligned is



in their support for stocking the 900m permits within the MSR to prevent further market distortion, rather than the Commission's backloading proposal of releasing them directly into the market by 2020.

**Figure 2: Emissions and cap in the ETS (million CO2 equivalent)**



Source: EEA, FTI Consulting calculations (presuming release into the market by 2018)

There are concerns that a more structural reform of the ETS will be needed to address the allowance surplus. The MSR may indeed not allow a rebalancing of supply and demand before late into the 2020s. The risk with a late starting date is that it carries excess permits and suppressed prices well into the next trading period, making the whole reform less effective.

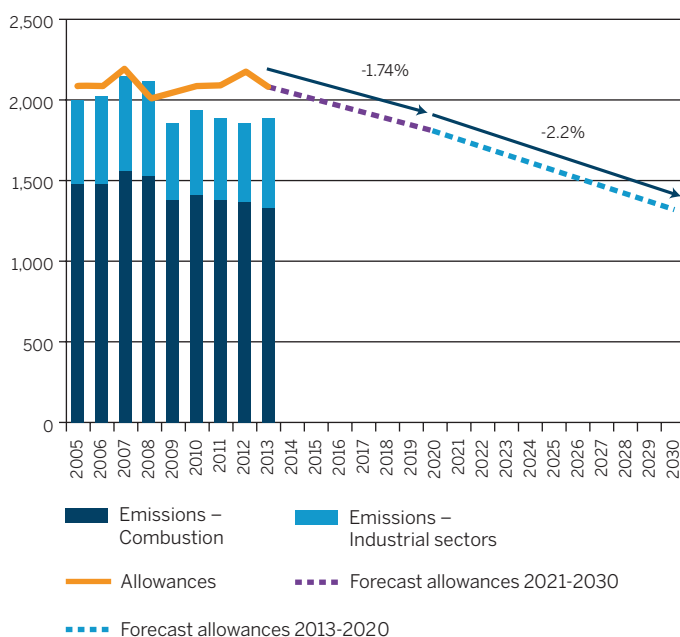
## THE FUTURE OF ETS

At the European Council in October 2014 European leaders agreed to a binding target to reduce greenhouse gas emissions by at least 40% by 2030. The ETS is the cornerstone to achieve this<sup>1</sup>. European leaders also agreed on some key elements of the post-2020 ETS:

- As of 2021 the annual factor to reduce the cap on maximum permitted emissions will rise from 1.74% to 2.2%;

- Free allocation for sectors that are in risk of carbon leakage will continue but benchmarks for these allocations will be periodically reviewed;
- Low-income Member States with a GDP per capita below 60% of the EU average can continue to give free allowances to the energy sector until 2030. After 2020 these should be not more than 40% of allocated allowances. The low-income threshold was lowered from 90%;
- A reserve of 2% of allowances will be set aside to address high investment needs in low-income Member States. The proceeds from the reserve is to be used for investments in energy efficiency and modernising the energy system;
- For sectors that do not fall within the ETS the methodology to set national reduction targets according to the Effort Sharing Decision will continue and all Member States have to contribute to an overall reduction of 30%. The emission reduction targets will be in the 0-40% range, compared to 2005.

**Figure 3: ETS allowances and emissions for fixed installations (million tCO2 equivalent)**



Source: EEA (excluding international credits)

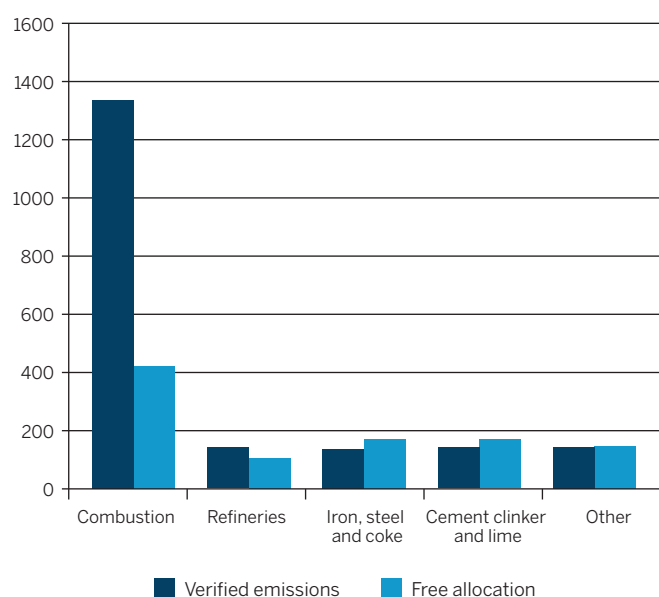
<sup>1</sup> See Energy Flash on the 2030 Energy & Climate Agreement

If the issue of excess permits is resolved, the system is forecast to work as illustrated in figure 3. However these elements only constitute the framework, and the debate has already begun on the structural reforms needed post 2020 to make the system work in the long run. Issues include the expansion of the ETS to sectors that are not yet covered and the way permits are allocated to sectors at risk of carbon leakage.

### Carbon leakage

Carbon leakage, that is the relocation of industry to countries with lower or no carbon emission standards, is a critical issue for Europe's energy-intensive industries. The Commission states that so far there is no evidence of carbon leakage having occurred, and addresses the issue by allocating free emission allowances to at-risk sectors. In the current trading period, the carbon leakage list covers practically the whole manufacturing sector and free allowances make up an important share in relation to actual emissions.

**Figure 4: Free allocation and verified emissions in 2013**



Source: EEA Trends and projections in Europe 2014

For the trading period starting in 2021 the Commission aims for an improved and better-focused system that encourages innovation. In the words of Jos Delbeke, Director General of DG CLIMA, the system has to be simple, predictable and effective. The impact assessment that started in early 2014 shows how difficult reform is going to be. The Commission is discussing the possibility of having fewer sectors in a carbon leakage list that would then better protect those sectors most at risk. This will lead to fierce discussions on the sectors to be included and the criteria to determine these.

Benchmarking, the methodology with which the number of free allowances is calculated for each sector, is another difficult issue in the ETS reform. Benchmarks should reflect the average of the 10% most efficient installations in a given sector. The benchmark value is then multiplied by the historic production data of the installation for products falling under the benchmark. Updating the benchmarks in the way that has been agreed by the European Council will be a cumbersome affair and business is wary that too frequent updating will increase uncertainty.

There is also disagreement about the data to be used to calculate the number of allowances. Under discussion are the current ex-ante approach, and the ex-post approach. The first uses historic data to forecast expected emissions, the second bases the allocation on actual emissions of a past period. While the second is more accurate and flexible, it would also risk increasing the administrative burden.

### Broadening the ETS

Today the ETS covers the most GHG-intensive sectors in the power and manufacturing industry. Since 2012 it covers aviation within the European Economic Area and with the start of phase 3 in 2013 also the aluminium, carbon capture and storage, petrochemicals and other chemicals sectors. In 2021 the European Commission considers broadening the scope to other sectors. This is in itself already controversial. Positions are ranging from including all sectors where it would not be excessively complex, to no further extension at all. Broadening the scope could make the system more efficient but could also be problematic in view of other existing policies. If other sectors are included it would be crucial to ensure overall coherence.

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## THE OTHER MAJOR QUESTION IS HOW THE SYSTEM CAN STRIKE A BALANCE BETWEEN ACHIEVING THE EU'S GHG REDUCTION TARGETS AND ENSURING A COMPETITIVE ENVIRONMENT FOR THE EU'S INDUSTRIAL SECTOR.

### Transport

As one of the largest CO<sub>2</sub> emitters transport is an obvious candidate for the ETS and Britain and Denmark are advocating for its inclusion. Including transport in the ETS could help addressing the oversupply of allowances and provide more flexibility to the car sector in reducing its emissions. However environmental campaigners are opposed to the idea, arguing that the current system of sector specific targets is more efficient in cutting emissions. In addition it would be very difficult to measure the emissions from the transport sector.

### Biomass

Currently burning biomass is rated at zero in terms of carbon emissions. This rating is based on the idea that planting and growing biomass captures the same amount of CO<sub>2</sub> that is released when the biomass is being burned. NGOs have launched a campaign to end zero-rating, arguing that plants do not necessarily capture all the carbon they release when burned, and that the capturing of CO<sub>2</sub> can take up to 500 years. Moreover, they argue, there is no way to verify the origin of the biomass, which could for example stem from ancient forests that are not being replanted<sup>2</sup>. In reply, the biomass sector claims that the amount of forested land in the EU is growing. Inclusion of biomass in the ETS is likely to be a tough sell for many Member States, even those that have more environmentally ambitious targets.

### WILL IT WORK?

The Commission will address these and other issues in its proposal for the revision of the ETS which is to be expected in the second half of 2015. Even after 2020 the key question will be whether allowance prices will be adequate to incentivise low-carbon technologies. MSR seems like a good idea on paper, but we will only be able to evaluate whether it will be able to make the ETS work at last once it kicks in. That is why it is important that the MSR should be introduced sooner rather than later, and well before the stated date of 2021.

In that context the inherent contradictions between the ETS that depends on a high carbon price and the push for increased energy efficiency through other policy instruments must be taken into account. This is going to represent an extremely difficult balancing act for the Commission so that one does not damage the other.

The other major question is how the system can strike a balance between achieving the EU's GHG reduction targets and ensuring a competitive environment for the EU's industrial sector. This question will be at the centre of the new framework and will prove extremely controversial. Energy-intensive industries claim to have improved carbon efficiency as much as is technologically feasible, while environmental advocates argue that investing in low carbon and green technologies will increase Europe's competitiveness. The fact that the EU's energy-intensive industries are most impacted by high energy costs also raises the question whether the free allocation of allowances is the right way to address this issue. "A better understanding of the real impact of higher carbon prices on competitiveness as opposed to high energy costs per se is critical for a factual debate" highlights Kavita Ahluwalia, ETS advisor at E.ON.

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<sup>2</sup>European Environmental Bureau, 17 March

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In view of the many opposing interests among Member States, industry sectors and political groups, the objective of devising a simple system will be a major challenge, as illustrated by discussions on how to calculate the free allocation of allowances. As it is often the case in the EU, added complication may well be the price of compromise.

The EU considers its climate policy as a driving force for international efforts, in particular to prevent major competitive disadvantages. Having established the ETS has certainly encouraged other economies outside the EU to introduce a cap and trade scheme and today some major emitters have introduced an emission trading scheme or are developing it, including California, China, Canada and South Korea. The ETS can therefore be seen as having contributed meaningfully to the global effort to fight climate change.

## IMPLICATIONS FOR BUSINESS

Significant sections of the business community have already made ETS reform a top priority. Sectors that have been less vocal on their inclusion in the carbon leakage list risk losing out. Every sector needs to carefully examine the potential business impact of the proposed reforms. This can require a comprehensive economic analysis as FTI Consulting provided on energy costs and subsidies or on the impact of ETS exemptions. At the same time, as the reform is very technical with many conflicting demands, it will be crucial for the Commission to base its reform on solid data. Business can help by providing sector-specific data and thereby contribute to the understanding of the economics of ETS.

Noise around ETS reform will increase over the course of this year in the run-up to the adoption of the ETS reform package and the climate conference in Paris in December. The key question is what a successful reform will look like in the world's largest carbon market. Getting your voice heard in this crucial debate will require a distinct message that stands out.

Finally, Commissioner Miguel Arias Cañete is responsible for both, climate action and energy. Approaches and ideas that combine lowering energy costs and reducing emissions is what he urgently needs.

**Arne Koeppel** is Head of Research and **Aylin Diriöz Fastenau** is a Consultant in FTI Consulting's Strategic Communications practice in Brussels.

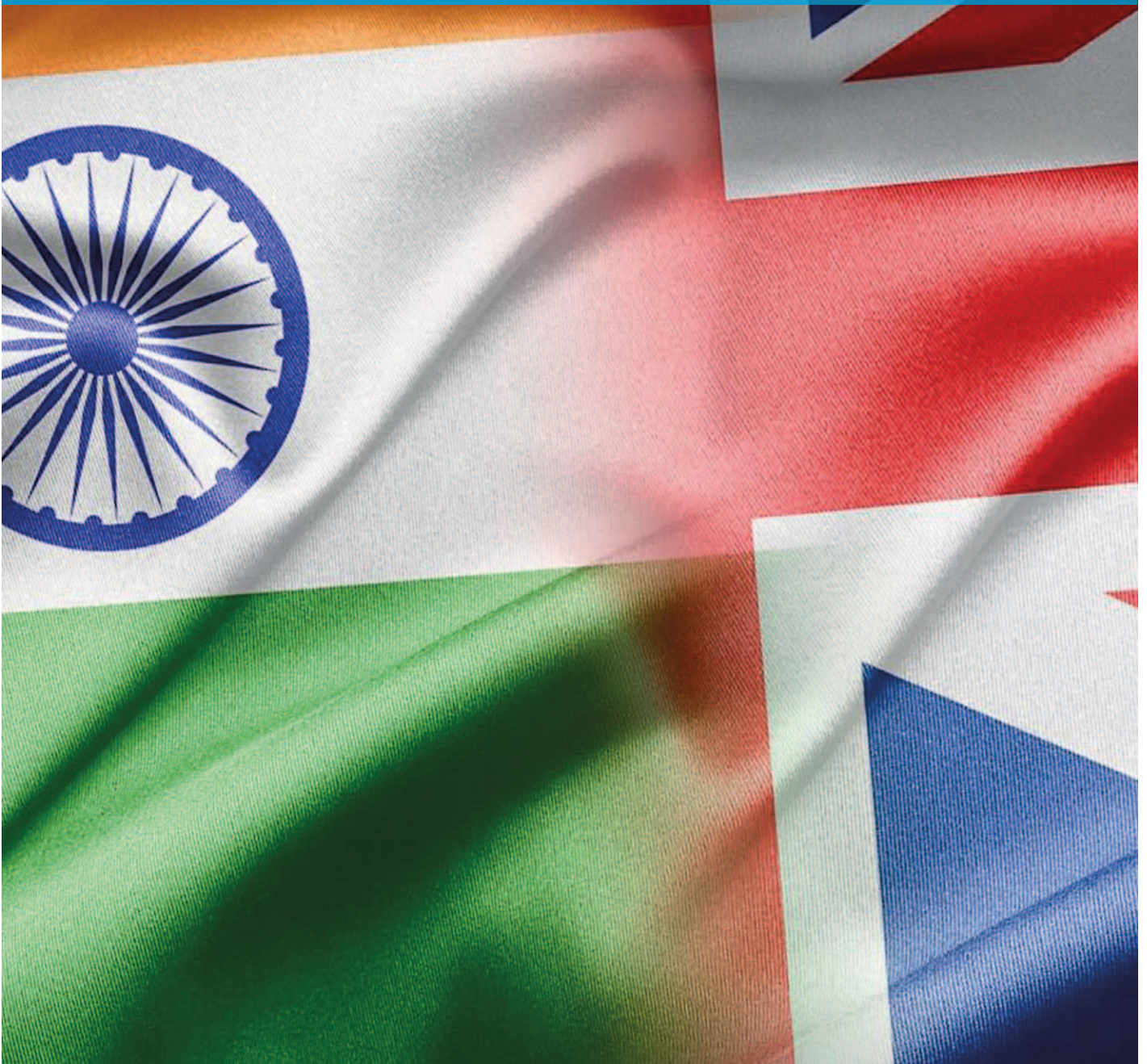
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## Britain and India: **Potential for an ever closer relationship**

Ahead of the visit by Indian Prime Minister Narendra Modi to the UK in November, Patricia Hewitt, Rishi Patel and Amrit Singh Deo explored the diplomatic, economic and political connections between the two countries and outlined the steps being taken to enhance cooperation and forge further strong ties.



Prime Minister David Cameron came to office in 2010 with a distinct aim to rejuvenate trade and investment partnerships with Commonwealth nations. His efforts to woo India have shown clear evidence of this strategy, and he commented in 2010, that although influential, both nations could not simply rely on their shared past and diaspora link, and that active endeavours would need to be made to enhance the relationship. Since then, new opportunities for cooperation have been realised, and political moves taken on both sides look set to liberalise prospects for the future.

Cameron's 2010 visit to India announced his will to extend "the hand of friendship" to India, bringing with him the biggest visiting delegation spanning government, business and cultural figures of any Prime Minister in recent times. More recently, there have been noteworthy displays of diplomatic warmth, with the then Culture Secretary Sajid Javid managing the unveiling of a statue commemorating India's founding father in 2014, remarking: "The relationship we have today with India is one that Mahatma Gandhi dreamed of - as friends and equals." Javid enjoys a close working relationship with Indian Minister of Finance, Arun Jaitley, and in his new role as Business Secretary, he looks set to enhance the UK's ties further, across the duration of the next parliament.

Other prominent Ministers are variously acting as champions of the Indian cause. Jo Johnson MP (Universities and Skills Minister) spent three years as the FT's South Asia Bureau Chief in New Delhi; in one of his first acts as Minister, he vowed to address the decline of Indian students studying in the UK. The Indian "Diaspora Champion" Priti Patel MP (Minister of State for Employment) who is the daughter of Ugandan Indian refugees, was recently honoured with the "Jewels of Gujarat" for her efforts to enhance economic partnership between the UK, and Gujarat State- one of India's most open, outward looking and dynamic economies, which is the ancestral home of many of Britain's Indian 1.5 million strong diaspora. There is clear warmth therefore, at a senior ministerial level for the success of this relationship.

PRIME MINISTER MODI'S VISIT PRESENTS REAL OPPORTUNITIES FOR BRITISH BUSINESSES TO FORGE RELATIONSHIPS WITH HIGH LEVEL INDIAN DECISION-MAKERS, AND TO SHOWCASE THEIR BRAND TO THE PEOPLE WHO MATTER.

#### **READY FOR BUSINESS**

At least initially, Prime Minister Modi's Government seemed less eager than the British Government to strengthen diplomatic ties. Following his landslide victory in 2014, Prime Minister Modi's initial foreign policy objective has been very clear: to re-establish India as an Asian regional power, and to build closer economic ties with China and Japan, who bring with them the prospect of multi billion rupee investment prospects. A new certainty brought about by a Conservative



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## BRITISH INVESTMENTS ARE SO DEEPLY INTEGRATED INTO INDIAN BUSINESS CULTURE, THAT THEY ARE SCARCELY SEEN AS FDI SUCCESS STORIES, BUT SIGNS OF THE INDIAN ECONOMY'S CONTINUED STRENGTH.

majority government in the 2015 General Election made a prospect of a visit ever more certain, the Indian government now comforted that the Conservatives would be their de rigueur counterparts. Modi, who was able to pack out New York's Madison Square Garden in a visit to the USA in September 2014, is due to host a similarly colossal summit at Wembley Stadium this November. This event will be as much about enthusing with patriotic zeal the 1.5 million British Indians living in the UK who are themselves a key source of remittances and investment, as it will be about showcasing India's readiness to do business with Britain on a macroeconomic scale. Glamorous summits aside, Prime Minister Modi's visit presents real opportunities for British businesses to forge relationships with high level Indian decision makers, and to showcase their brand to the people who matter.

### MASALA BONDS AND COMMERCIAL JETS

And ready they are to do business. The Indian boom has provided new opportunities for inward investment into the UK, with Indian companies particularly keen to take advantage of the research and development opportunities available in the UK's knowledge economy. Mumbai based pharmaceuticals giant Cipla announced in 2014, £120 million of investment into scientific research and development from the country. Mahindra & Mahindra, the leading automobile manufacturer has pledged £20m of funding into Britain, ring-fenced for electric vehicle technology. In moves to deepen integration in financial services, increasing capital flows are being issued on the London Stock Exchange. In August, The International Finance Corporation (IFC) launched the first green Indian rupee "Masala" bond, on the London Stock Exchange, the 12th rupee denominated bond of its kind. The Bond's ultimate aim is to galvanize private sector investment in Indian green energy and infrastructure. High profile international deals with implications for the British economy have also demonstrated continued commitments to invest in the UK. In August 2015, Airbus announced a deal with Indian budget airline IndiGo, worth £17bn at list prices, to sell 250 of its A320neo jets. A positive result for the British Government, who are keen to ensure prosperity is spread beyond London

the South East, with this order assuring jobs and investment for Airbus in their North Wales manufacturing plant. Of course the scale and variety of Indian investment into the UK is crucial, indeed the country invests more into the UK than it does in the whole of the rest of the EU combined.

### UK PLC. (HINDUSTAN)

Britain has continued to invest palpably into India's success, across a range of industries. The UK ranks first out of the G20 economies in terms of investment into India. Moreover, with a large proportion of FDI from Asian countries originating from the City of London, the UK is most certainly the number one investor globally. Around £3.2bn was invested in India in the 2013-14 financial year alone, and this figure looks set to increase as moves are made to encourage businesses of all sizes and not just corporations, to consider India. Sterling Assets India, a report published in September 2015 by the CBI in association the UK-India Business Council, has confirmed the sheer scale of the UK's investment, revealing that UK firms account for 1 in 20 of India's formal private sector jobs, with G4S being one of the biggest private sector formal employers in India. The report found that in terms of sector, the two British key industries investing in India were chemicals (\$5.78bn) and drugs and pharmaceuticals (\$3.76bn). The report cited that overwhelmingly, the largest attraction to India was its large and growing home market, followed by the availability of talent.

British investments are so deeply integrated into Indian business culture and branding, that they are scarcely seen as "FDI success stories" but signs of the Indian economy's continued strength. Unilever pledged to spend as much as £3.5 billion to bolster its "Unilever Hindustan" offering in 2013. India's construction boom, coupled with increasing efforts by the Modi government to invest in infrastructure has provided a host of new opportunities for British construction businesses, including JCB which opened its largest overseas factory in Jaipur in 2014. Many British household names from Vodafone to Marks and Spencer, continue to expand their Indian reach, generating employment and enhancing prosperity.

### MAKE IN INDIA

Mr. Modi's BJP (Bharatiya Janata Party) achieved a landslide victory in 2014, promising to meet the aspirations of young Indians, who above all are hungry for jobs. The Prime Minister has launched his flagship campaign "Make In India" to do just that, and generate the hundreds of millions of jobs that the country desperately needs. But it is through investment, both domestic and foreign, that Modi hopes to achieve this ambition, and more needs to be done to modernize the economy to make it fertile territory for investment. A great deal of progress has already been achieved, on eliminating red tape, e-filing and the abolition of bureaucratic permits. Insurance has been a key industry where the elimination of FDI restrictions will see a surge of new investment, and recent investment intentions by Bupa, Standard Life and Aviva demonstrate this intention. There are moves to liberalise legal services, with the Indian Bar Council in positive talks to create a more fertile legal climate for international firms. Modi's "competitive federalist" approach now means individual Indian states are now competing to provide the most attractive destinations for international investment.

A GREAT DEAL OF PROGRESS HAS ALREADY BEEN ACHIEVED, ON ELIMINATING RED TAPE, E-FILING AND THE ABOLITION OF BUREAUCRATIC PERMITS.

But there have been significant challenges along the way, not least due to Modi's own domestic legislative quandaries. Although reduced to a meagre 44 out of 542 seats in the Lok Sabha (Lower House), the opposition Congress party still controls the Rajya Sabha (Upper House) and is flexing its muscles where it can, to stall the BJP's plans, and disrupt the government's momentum. Modi's key aim; to simplify India's notoriously complicated Tax system with a nationwide "Goods and Services Tax" (GST), was squarely defeated in August 2015 by opposition Congress politicians, some of whom had called for similar legislation when they were in power.

The pace of reform will therefore be slower than expected, and after his UK visit, Modi will likely concentrate on domestic politics and the 2016 state elections, to secure a majority in the Rajya Sabha in order to pass through key pieces of legislation. Moreover, global economic uncertainty will continue to mean that business relationships may well fail to realise their true potential. As China slows and suffers increasing market turmoil, impact on the world's growth may slow down India's projections. Analysts, who may earlier this year have been predicting 8% Indian growth, have been seriously dressed down and the forecast post July remains squarely at or below 7%.

There is certainly immense will amongst political and business leaders, for an ever enhanced relationship between these former and future economic superpowers. With new regimes and legislative agendas in place in both nations, the next five years look set to bring further rounds of diplomatic and trade negotiations, and there is tremendous scope for more to be achieved on already strong foundations.

Yet there remains the fear that amongst all the discussion, certain factors make enhanced cooperation more difficult to achieve. At home, Mr Modi needs to ensure that he is able to carry forward his legislative agenda of domestic change, to make the landscape as fertile for investment as his rhetoric suggests. Indeed he is likely to face criticism from domestic political and business audiences, if he is unable to bring about this change. Moreover, the whole world is attempting to court India, and Britain faces extremely fierce competition from the US, Germany, France, Australia and of course, China and Japan.

Senior British business and political leaders need to ensure that the opportunities thrown up by delegations and visits are capitalised upon, and all relevant groups with a stake in making sure that this alliance is a fruitful and prosperous one, work hard to showcase to India that Britain is ready to buoy and be buoyed by, the second stage of an Indian economic miracle, which is mutually beneficial, long-lasting and across industry.

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