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Latin America Corruption: Keep Calm and Carry On?

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Over the past 18-24 months, governmental authorities across Latin America have pursued corruption investigations with a vigor traditionally not seen in the region. From Mexico, through several Central American countries, down to Chile and finally engulfing the largest economy in the region, Brazil, corruption investigations – domestic and multi-jurisdictional – are significantly disrupting politics and business as tolerance for corruption seems to have fundamentally changed.

The recent more rigorous pursuit of corruption allegations results from a combination of factors ranging from the passage of new anti-corruption legislation, to better training and a greater allocation of resources to local prosecutors, to greater public access to information on such allegations. Leaving aside the origins and potential political consequences of this phenomenon, what are the implications for those attempting to do business in this shifting environment – whether they are themselves the subject of an investigation or they are doing business as a provider or underwriter of financing, a joint venture partner, a purchaser of assets or any other commercial counterparty with an entity alleged to have engaged in corrupt conduct? More fundamentally, should counterparties to persons or entities, which are a subject of a corruption investigation, stop dealing with them while the investigation is ongoing? Can a subject convince potential commercial counterparties that business can and should continue?

Since most investigations take at least a year and often three to five years or longer to resolve, it is important to note that past experience tells us that business activity can continue with an entity that is being investigated – if proper mitigating measures are taken. This article will examine the issues to be considered in these circumstances and discuss some of the precautions to be taken and mitigating measures which can be implemented so that business can continue at an acceptable risk level.

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Lessons Learned

There are a number of examples, such as the Nokia-Siemens Network joint venture and York International, in which companies decided to proceed with commercial transactions, including securities offerings and joint ventures, notwithstanding an ongoing multi-jurisdictional corruption investigation. In both those cases, and in a number of others, the decision to proceed proved to be astute as the transactions are widely regarded as successful and the parties which were not the subject of the investigation were not later alleged to be involved in any corrupt conduct.

On the other hand, we see examples such as Latin Node and Titan/Lockheed where an ongoing investigation derailed a commercial transaction. In Latin Node, eLandia's investment in the Honduran telecommunications company was wiped out within one year of its purchase because eLandia's pre-investment investigation failed to detect that Latin Node's concession agreement in Honduras had been obtained by corruption. In Titan, Lockheed Martin walked away from a proposed acquisition of Titan when Titan failed to resolve an FCPA investigation. Titan was subsequently acquired by another company after it pled guilty to FCPA violations.

We have learned a number of lessons from these and other precedents.

First, multi-jurisdictional corruption investigations are not over until they are over. Thus, though typically most of the relevant information is revealed relatively early in the investigative process, new significant information could come to light as the web of the investigation expands, particularly as additional jurisdictions and parties become involved.

Second, it is only possible to mitigate the risks in these situations, not eliminate them.

Third, the risks associated with each situation — whether it is prudent to proceed with a transaction and the appropriate mitigants to implement — are unique and driven by the specific facts.

Risks to be Considered

While each investigation is unique, the risks to be considered generally fall into several categories. These risks are the ones which any entity proposing to enter into a transaction with an entity which is the subject of a corruption investigation will want to consider. They are also the risks which the subject will need to convince its potential business counterparties can be managed. Finally, these risks must be considered and addressed regardless of whether the allegations ultimately prove true or false and, if true, their magnitude. The fact that the allegations have been raised and the authorities have instituted an investigation require that they be addressed.

The risk categories include, among others:

- likely adverse effects on ongoing business, including disruptions to existing business operations and relationships and on future opportunities, and whether those effects are manageable;
- potential adverse financial consequences, ranging from temporary liquidity constraints to significant impairments to creditworthiness, which could adversely affect an ability to perform commercial and financial obligations in the ordinary course, pay debt service obligations when due or meet any impending extraordinary obligations;
- effects on the value of particular assets (such as concessions, permits or contracts with governmental entities which could be void if granted on the basis of corrupt payments);
- potential for “contagion” – the spread of the original allegations to other aspects and regions and the likelihood that other jurisdictions will institute investigative proceedings;
- potential for other transaction parties to become ensnared in the proceeding because of the proposed transaction; and
- potential for an investigation to become politicized and therefore more difficult and lengthy to resolve.

Managing the Risks

The measures instituted to manage the risks related to potential corruption situations should generally be designed to achieve certain fundamental ends. These include:

- determining whether there is any likelihood of an impairment of the value of the asset or business that will be the subject of the proposed transaction;
- providing support for or otherwise structuring around any potential impairment of the creditworthiness of the counterparty to the extent relevant to the proposed transaction;
- maximizing the likelihood of determining if there is ongoing corrupt conduct of the type alleged or otherwise;
- ensuring going forward that an enhanced and robust compliance program is in place and being enforced with the counterparty and for the related business;
- demonstrating to the investigators and any relevant regulatory authorities that there is no knowing participation in or support for any alleged ongoing corrupt conduct; and
- assessing the likelihood of politicization of an investigation and the likelihood that the non-subject entity would become involved in a domestic political dispute.

Basic Measures

Need for Experienced Advisers: Appropriate measures should, at a minimum, include the engagement by the subject of an independent, internationally recognized team of experts in the area of multi-jurisdictional corruption investigations. The investigation should seek to uncover the facts deemed relevant to the business’s prior conduct related to the proposed transaction. The key is to establish the credibility of the independent investigative team with the government investigators. The independent investigation will need to have an appropriate scope and use methodology and processes satisfactory to the government investigators. The subject should coordinate the engagement of such team with potential counterparties to material non-ordinary course transactions. In addition, the subject should allow such counterparties to

participate in the investigation through their consultants by, at a minimum, providing ongoing oversight of the investigation, periodic consultation on findings and participation at appropriate times in key investigation steps.

Conditions to Closing: The proposed transaction should include a set of conditions to entry, such as satisfaction of the counterparty with the above investigatory process and its conclusions.

Robust Compliance Program: The prior compliance program of the subject should be reviewed by the independent team, and enhancements to ensure a robust compliance program designed to prevent future issues of this type should be adopted and rigorously implemented.

Manage Cashflows: The cashflows from the proposed transaction should be managed so as to minimize any implication that the proposed transaction is being used to further any alleged corrupt conduct in business unrelated to this transaction.

Dialogue: The potential counterparty should establish a dialogue with the relevant governmental investigators and the subject should be supportive of that dialogue. Though the investigators will likely not bless any proposed transaction or even provide substantial input as to the sufficiency of the mitigation measures, it is important to make them aware of the transaction, the measures being taken and the intentions so as to avoid any misunderstanding of the motives and objectives of any entity not a subject of the investigation. Despite the likely lack of explicit advice provided by the investigators, limited guidance can often be obtained, giving all helpful comfort.

Conclusion

There are inherent risks in executing business transactions — be they loans, capital markets issuances, acquisitions, joint ventures or other commercial arrangements — with an entity that is the subject of a domestic or multi-jurisdiction corruption investigation. Despite these risks, there are a number of precedents showing that such transactions can be done successfully if the proper steps are taken to isolate the prior alleged conduct from the proposed transaction. Given the length of time it takes to complete these investigations, it is usually impractical to consider waiting for their conclusion. Thus, the decision becomes whether to move forward with a transaction or forego the opportunity. If the decision is to move forward, crafting a comprehensive and effective mitigation plan is key to making the transaction possible and for it to be successful.

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