Brazil and the FCPA

From understanding Brazil's *jeitinho* way of doing business to dealing with *despachantes*, there are various issues to be aware of when investing in Latin America's largest economy in order to not fall foul of the FCPA. **Thiago Spercel** and **Gustavo Pinto**, associates of Simpson Thacher & Bartlett LLP, provide some tips

Thiago Spercel

Gustavo Pinto

In recent years, the number of enforcement actions brought under the US Foreign Corrupt Practices Act (FCPA) has dramatically increased. In 2004, the US Department of Justice (DoJ) and the US Securities and Exchange Commission (SEC) brought only two and three FCPA enforcement actions respectively, compared to 48 and 26 such actions in 2010. The monetary sanctions associated with these enforcement actions are also on the rise. In 2008, the DoJ, the SEC and the Munich Public Prosecutor's Office brought an enforcement action against Siemens AG that resulted in the payment of US$1.6 billion – the largest anti-corruption settlement to date.

This hard-line stance on corrupt business practices worldwide exposes investors and companies with a global presence to significant potential liability in the absence of preventive internal policies and due diligence procedures. This is of particular relevance for companies and investors doing or considering doing business in countries that have experienced highly publicised incidents of corruption. Although unfortunately too many countries seem to fit this description, in light of its impressive recent development, Brazil's case deserves a closer look. Indeed, Brazil has been widely regarded as one of the most dynamic business environments in the world over the last few years, being the top recipient of foreign direct investment in Latin America. However, corruption is perceived to be a significant challenge. Since the beginning of her government in January 2010, President Dilma Rousseff's administration has lost six ministers to corruption allegations. The Transparency International's 2011 Corruption Perception Index (CPI), which uses annual surveys to measure the perceived level of public-sector corruption in 182 different countries and territories, with scores ranging from (most corrupt) to 10 (least corrupt), has ranked Brazil 73rd with a score of 3.8, far behind other Latin American countries.

The *jeitinho* way

Brazil has been undergoing a transformation driven by economic growth and improvements in the population's socio-economic profile. New business opportunities have opened up in Brazil as a result of economic growth, increased family income, credit availability, declining unemployment rates and increased levels of investment.

Despite this, Brazil is still marked by certain factors typically associated with higher corruption risks, including the country's bureaucracy. According to the World Bank's 2012 Doing Business Index, Brazil ranked 126th out of 183 countries worldwide. Such a complicated bureaucratic environment offers opportunities for corrupt behaviour, including public official demands for inducements in order to grant permissions or authorisations.

The country's vast territory is another characteristic that increases corruption risks. Brazil is the fifth-largest country in the world in terms of territory, with a

relatively decentralised government structure. The combination of geographic expanse and a perception of impunity set the stage for corrupt behaviour in isolated areas that are subject to less governmental oversight or media scrutiny.

The legal framework intended to combat corruption in Brazil also presents challenges. Although acts of bribery are criminalised under Brazilian law, both on the part of the persons offering unlawful payments and on the part of public officials receiving such payments, there are no laws that require companies to develop internal mechanisms to prevent corrupt acts. In addition, Brazil's justice system is considered to be slow in dealing with alleged corruption when formal charges are brought. The Brazilian justice system is characterised by a broad range of appeals to defendants which, combined with an overburdened judicial system, allows appeals to drag on for many years. In this context, skilled lawyers are able to prolong legal proceedings for several years, until they reach their statute of limitations. This situation contributes to a general sense of impunity, which may further promote corrupt behaviour.

In addition to, or perhaps as a result of these factors, the Brazilian corporate environment is often culturally marked by a somewhat "laid-back" approach to rules and regulations. This is typically referred to as the "Brazilian way," or the "*jeitinho*", which refers to the creativity of Brazilian people in everyday situations to manage certain difficulties, bureaucracies or obstacles. Although this flexibility can represent a competitive advantage for doing business in Brazil, it can sometimes cross the line into ethically questionable, or even illegal, behaviour that may implicate the FCPA.

FCPA concerns in Brazil

The FCPA provisions can generally be divided into the anti-bribery prohibition and the books and records and internal control provisions. The anti-bribery prohibition is designed to prevent unlawful payments to foreign officials for the purpose of obtaining or retaining business, while the books and records and internal control provisions require the maintenance of reasonably accurate accounting records and adequate internal controls.

The anti-bribery provision applies to:

- "issuers", defined as any company with a class of securities registered with the SEC, regardless of its jurisdiction of incorporation or principal place of business;
- any "domestic concern", a term defined to include any US citizen or US company, regardless of whether the company has any securities listed with the SEC; and
- any person or entity who takes an act prohibited by the FCPA while in the territory of the US.

This third category is particularly broad and could be used to charge non-US citizens or companies with FCPA violations based solely on, for example, the use of funds raised in the US or the use of US bank accounts as a means to make unlawful payments. The definition of "foreign official" under the FCPA is also quite broad and includes officials of any non-US government, employees of an entity that is wholly or partially state-owned, political party officers, candidates for office, and employees of public international organisations.

The second major component of the FCPA, the books and records and internal controls provisions, requires that all "issuers" maintain books and records that accurately reflect, in reasonable detail, all expenditures of the company. Unlike the anti-bribery provision, this provision is generally not applicable to domestic concerns or companies doing business in the US if the company does not have securities registered with the SEC. The provisions require that issuers institute internal controls sufficient to ensure that all payments made with corporate assets have been duly authorised by management. In addition, they impose requirements on an issuer with respect to foreign or domestic subsidiaries in which it holds a majority stake. Importantly, even for a foreign or domestic entity in which an issuer holds a minority stake, the issuer is required to use its influence, to the extent reasonable under the circumstances, to cause the company to make and keep books and records that accurately reflect the transactions of the corporation and to maintain an adequate system of internal accounting controls.

The FCPA contemplates certain important affirmative defences and exceptions. For example, the payment of gifts, offers or promises that are lawful under the laws of the recipient's country, as well as moderate sums paid in good faith, such as travel expenses in connection with promotion of products or services, are not penalised under the FCPA. Therefore, the action must be illegal both in the US and the country where the transaction occurred to constitute an FCPA violation.

This is particularly relevant in Brazil, where certain codes of conduct have been adopted by government entities and state-owned companies setting forth general rules to be followed when dealing with the public sector. One of the most significant codes of conduct applicable to public agents in Brazil is the Federal Administration's code of conduct. This code applies only to officials holding high-ranking functions in Brazil's federal administration, laying out rules pertaining to the acceptance of gifts, and trips to which they may be invited among other specific rules. Certain state-owned companies have also adopted their own codes of conduct, such as Petrobras, Brazil's state-owned oil giant and Brazil's development bank, BNDES. These codes are useful tools not only for public officials, but also companies or investors doing business with the public sector, as strict compliance with such codes could provide an affirmative defence under the FCPA. In this regard, it is important to mention that, although subject to dispute, the DoJ and the SEC have interpreted in the past that state-owned companies in foreign countries can be an "instrumentality" of a foreign government, such that employees of state-owned companies are "foreign officials" under the FCPA, even if the foreign government is a minority investor in the enterprise.

The FCPA also provides an exception for payments related to "routine governmental action," also known as "facilitation" or "grease" payments. This exception covers only ministerial duties that do not involve discretionary decisions, but only seek to expedite a governmental procedure. Although such payments are not illegal in the US (under narrow circumstances), they must still be properly recorded in a company's books and records. In fact, several US companies

have stopped allowing facilitation payments because this exception is hard to navigate and because the payments are often unlawful in foreign jurisdictions.

Facilitation payments is an important issue in Brazil due to the widespread use of *despachantes*, also known as "forwarding agents". In a country with a complicated bureaucracy, overcoming red tape often requires paying fees for expedited services or using local facilitators. The despachante is a type of agent that is hired in order to push proceedings through bureaucratic channels. This agent is widely used in transactions that depend on authorisation from public entities, such as obtaining the proper import-export authorisations. The use of *despachantes* is not illegal in Brazil, and usually represents a valuable alternative for those that do not have the time or familiarity with the intricacies of the bureaucratic process.

Nevertheless, it is important to note that this exception for "grease" payments should be interpreted narrowly, not permitting payments to foreign officials with the intent of securing new businesses or continuing existing businesses. Another important aspect to keep in mind is that, following the tradition of the Brazilian *jeitinho*, the *despachante* may sometimes deviate from the proper legal channels in order to reach the desired end (sometimes without the client's authorisation or knowledge). Therefore, companies and investors considering hiring the services of a *despachante* in Brazil should always be mindful of the nature of the act being sought and also the methods adopted by such agent, monitoring the *despachante* closely. In addition to prohibiting payments to foreign officials directly, the FCPA also prohibits payments to any persons or intermediaries, while knowing or having reason to believe that that such payment will be offered, directly or indirectly, to a foreign official.

FCPA enforcement in Brazil has been on the rise, with many enforcement actions being brought in the last decade, such as *Panalpina* (2010), for an alleged scheme to pay bribes to numerous foreign officials on behalf of many of its customers in the oil and gas industry, and *Nature's Sunshine Products* (2009), for alleged cash payments to customs officials to import products into the country and purchasing false documentation to conceal the nature of the payments. More recently, Embraer, a Brazilian aircraft manufacturer, announced that it is currently under investigation by the SEC and the DoJ for possible FCPA violations relating to operations in four undisclosed countries.

Mitigating FCPA risks in international investments

Investments by US persons in certain countries or industries may create FCPA risks, requiring special precautions. The appropriate level of FCPA due diligence will vary depending on the intended investment. Common red flags include the receipt of "improper payment" audits in years prior, the country's reputation for corruption or history of FCPA violations, or transactions with an industry that has a track record of FCPA violations. A reliable indicator of Brazil's susceptibility to corruption, and consequently the level of recommended diligence, is the already-mentioned CPI index. The industry or sector in which the target operates can also have a significant impact on the FCPA risk assessment. For example, if the company operates in a traditionally high-risk industry, uses third-party services for significant parts of its operations or requires significant government licences or permits to operate, investors should consider a more detailed FCPA due diligence. Certain heavily regulated sectors in Brazil, such as oil and gas, pharmaceutical and public utilities, may be particularly concerning.

In the context of a merger or an acquisition, it is very important for the acquirer to conduct a thorough diligence to determine whether past FCPA violations could result in monetary penalties and reputational damage to the target. From the acquirer's perspective, although the FCPA does not impose strict liability for illegal acts performed prior to the acquisition, the acquirer may be held liable if it knows or has reason to know that the target has engaged in FCPA violations. For these reasons, a well-documented FCPA due diligence is critical in helping to uncover and address potential FCPA concerns before an investment is made, as well as to protect the investor should issues arise later. If an acquirer has done reasonable due diligence and followed up on significant red flags, it will likely be able to defend against liability for pre-acquisition conduct. The exact level of FCPA due diligence, however, is very fact-specific. Depending on an initial risk assessment, additional steps may be advisable to ensure FCPA compliance, such as background checks with independent sources, forensic audits and interviews with management, clients and suppliers.

In addition to conducting a thorough investigation prior to making an investment, investors should negotiate FCPA-related contractual provisions, obtaining representations and warranties from local partners that they have not violated applicable anti-bribery laws, with special indemnification provisions to protect against FCPA liability. Similarly, acquisition documents should include covenants requiring the target and the local partners to use best efforts to prohibit acts of corruption, with the right of the investor to terminate the investment if FCPA violations arise.

Investors should also consider other post-closing remedial measures, such as the implementation of a formal anti-corruption policy to be followed by the target. The policy should include a statement of the target's commitment to complying with applicable anti-bribery laws, routine internal audits, creation of a compliance department and a reliable reporting system. Employee training with respect to anti-bribery laws could also be an efficient preventative tool.

FCPA enforcement is an increasing concern, and international investors doing business or investing in Brazil should be mindful of the importance of FCPA compliance. Brazilian entrepreneurs should also be aware that the adoption of anti-corruption practices, with reliable internal controls and policies to prevent and punish illegal payments, may represent an attractive feature for international investors who are subject to FCPA enforcement, adding value to a potential sale of shares or assets.

It is also worth mentioning the existence of other important anti-corruption statutes that should be taken into consideration when doing business in Brazil and elsewhere, such as the OECD Anti-Bribery Convention, and the UK Bribery Act in particular, which substantially strengthens the legal framework to combat bribery in the United Kingdom and internationally.