

## Government Contracts and the Importance of Due Diligence in Brazil

**The resignations of two members of Brazilian President, Dilma Rousseff's, cabinet in 2011 have highlighted corruption as a pertinent issue to be considered by businesses operating in Brazil. As the country prepares for the 2014 World Cup and 2016 Olympic Games, companies awarded government contracts need to be aware of the importance of carrying out due diligence in order to be compliant with strict anti-bribery legislation.**

In 2011, two prominent Brazilian politicians, Alfredo Nascimento and Antonio Palocci, resigned following allegations of corruption. These events have brought the issue of corruption in Brazilian politics to the forefront of current issues facing businesses operating in Brazil. While Brazil's economy is experiencing rapid growth, the scale of corruption in Latin America's largest economy is extremely high. As a result foreign companies are increasingly taking steps to protect themselves so they do not breach the anti-bribery legislation including the UK's Bribery Act and the US Foreign Corrupt Practices Act (FCPA).

### Booming BRIC

As one of the BRIC countries, Brazil has risen to prominence as one of the world's leading economies while many European countries are slowly returning to economic growth in the wake of the global financial crisis. International Monetary Fund's (IMF) [statistics](#) indicate that Brazil is the world's seventh largest economy in terms of nominal GDP and [according](#) to the Instituto Brasileiro de Geografia e Estatística (IBGE), the government's national statistics agency, Brazil's economy grew in 2010 by 7.5% on the previous year.

In short, Brazil's economy is booming and inward investment has flooded in to the country in recent years. The national economy is benefitting from its vast wealth of natural resources, growing consumer demand and increased government investment in the run up to 2014 World Cup and the 2016 Olympic Games. In preparation for these two global events, Brazil is upgrading its natural infrastructure, which provides companies operating in the construction, utilities and infrastructure sectors with significant investment opportunities.

Nevertheless, economic growth has not occurred without its problems. Corruption is considered to be a major problem in Brazil. Transparency International's Corruption Perceptions Index for 2010 gives Brazil a rating of 3.7, which puts it on a par with Romania and Cuba, making it more corrupt than Rwanda and South Africa and only marginally less corrupt than China. The World Economic Forum's (WEF) Global Competitiveness [Report](#) ranked corruption as the seventh major obstacle perceived by businesses operating in Brazil ahead of political instability and workforce education.

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### Corrupt Public Officials: A Persistent Problem

According to the WEF Report, Brazil ranks 127<sup>th</sup> out of 133 countries in terms of public trust in politicians. The 2005 Escândalo do Mensalão, the so-called monthly payment scandal, that exposed high levels of corruption in Brazilian politics was demonstrative of the wide scale extent of corruption in Brazil. In 2005, the *Folha de São Paulo* reported that the ruling Partido dos Trabalhadores, the Workers Party (PT), had paid congressional deputies of the Partido Trabalhista Brasileiro, the Brazilian Labour Party (PTB), a monthly bribe of BRL 150,000 so that they would vote in favour of government legislation. The payments system was reportedly run by Marcos Valério, a high profile PT politician, who channelled funds made from state-owned companies' advertising budgets and paid from a company owned by Valério to PTB politicians. The scandal nearly brought down President Luiz Inácio Lula da Silva's government with many senior politicians forced to resign in the aftermath. State-owned and privately-owned companies were also found to be complicit in the scandal including state-owned financial institution, Banco do Brasil, which is alleged to have funded Valério's bribe payments.

Nascimento and Palocci's recent resignations reinforce the perception that high level corruption remains entrenched within the political establishment and deep rooted mistrust of public officials persists. Antonio Palocci, who had been embroiled in the Mensalão scandal and served as President Rousseff's Chief of Staff, was forced to resign in June 2011 after the *Folha de São Paulo* [reported](#) that Palocci's personal net worth was 20 times larger than it had been four years earlier. It was the second time in Palocci's career that he was forced to resign following allegations of corruption. The Brazilian newspaper stated that prior to his appointment as Chief of Staff he purchased two properties for over BRL 7 million yet in 2006 he declared his personal wealth was just BRL 375,000. The *Folha de São Paulo* highlighted that Palocci's salary, which amounted to BRL 974,000 per annum, would not have given him the sufficient funds required to purchase such expensive properties and raised questions over where his money had come from.

In July Alfredo Nascimento, the Brazilian Transport Minister, was forced to resign following allegations made by [O Globo](#) that he and Transport Ministry civil servants had made irregular 5% commissions on state contracts. The paper also alleged and that his son, Gustavo Morais Pereira had made huge sums of money from contracts issued by the Transport Ministry. The value of company owned by Morais Pereira, Forma Construções, rose from BRL 60,000 to BRL 50 million in just two years after it benefitted from a company awarded public works contracts, SC Carvalho Transportes e Construções. Morais Pereira is now the subject of an investigation by the Federal prosecutors who have called into question the transparency of the company's business dealings

### The Construction and Infrastructure Sectors: The Importance of Due Diligence in Brazil

The *International Business Times* [highlights](#) that "construction in Brazil is huge now – as such, the Transport Ministry is a key player in the handing out multi-billion dollar contracts, ahead of the 2014 World Cup tournament". Transparency International along with organisations such as the Global Infrastructure Anti Corruption Centre (GIACC) and programmes such as the [Construction Sector Transparency Initiative](#) have consistently highlighted the high levels of corruption and lack of transparency in in publicly financed construction projects. The proximity of the sector to foreign officials and the sheer volume of projects currently being undertaken in Brazil only serve to increase the corruption risk in the country. It is therefore unsurprising that in recent years, international companies operating in Brazil such as Tyco and Bridgestone have fallen foul of the high standards of the FCPA and highlight the importance of complying with anti-corruption legislation when operating in the Brazilian construction and infrastructure industries.

In 2006, Tyco, a US-based industrial and manufacturing conglomerate, was fined by the US Securities and Exchange Commission (SEC) for bribes and corrupt remuneration paid by Tyco subsidiaries to Brazilian government officials. According to the [SEC](#), Tyco acquired its Brazilian subsidiary, Earth Tech Brasil, which was involved in constructing and operating water irrigation system for government authorities, despite the fact "that its due diligence for the acquisition revealed that payments to government officials were common in Brazil and were portrayed as necessary in the industries in which Earth Tech Brasil conducted business". The SEC claimed that "from 1999 through 2002, employees at Earth Tech

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Brazil repeatedly paid money to various Brazilian officials for the purpose of obtaining business...the payments to Brazilian officials were so widespread that approximately 60% of Earth Tech Brasil's total contracts involved some form of payment to a government official".

The SEC pursued Tyco's activities and issued a heavy fine claiming that the firm was aware of payments to public officials and that "the misconduct was made possible by Tyco's failure to implement procedures to prevent and detect FCPA misconduct". This case highlights the importance of carrying out adequate due diligence in Brazil and to maintain and implement adequate policies and procedures to detect and deal with corruption.

Brazil's decentralised federal system of government also makes it more susceptible to corruption in public works contracts. *The Economist* has [described](#) Brazil as the "self-harming state" because foreign companies need to work their way through the various Federal, State and Municipal levels of government to secure the relevant approvals for government contracts. The different layers of government involved in issuing public contracts means that there is wider and deeper contact with public officials. Moreover, state-owned entities such as Petrobrás, Banco do Brasil, Electrobrás, Telebrás and Sabesp, dominate their respective industries and often, foreign companies will need to work in partnership with these companies that are closely linked to the Brazilian government.

The growing number of anti-corruption policies and increased internal will to combat corruption in Brazil reflects the growing efforts being made to reduce corruption in international business transactions. Following Palocci's resignation as President Rousseff's Chief of Staff, *Mercopress* reported that he briefly took a position as a Director of Petrobrás, the state-owned oil company, but was forced to step down two days later due to the negative impact the appointment had on Petrobrás' reputation. The case exemplifies the increased pressure and accountability of Brazilian companies and the importance of protecting corporate reputations. Stricter international standards are forcing Brazil to take action to combat corruption and the government is reported to be considering introducing stricter anti-corruption legislation.

As Brazil develops its national infrastructure in the lead up to the 2014 World Cup and the 2016 Olympic Games, foreign companies are taking advantage of the numerous public contracts being offered in the infrastructure and construction sectors both independently and in joint ventures or consortiums with local Brazilian companies. The resignations of Nascimento and Palocci highlight the importance of carrying out due diligence when operating in these industries in Brazil. In 2006, Tyco, a US-based industrial and manufacturing conglomerate, was fined by the US Securities and Exchange Commission (SEC) for bribes and corrupt remuneration paid by Tyco subsidiaries to Brazilian government officials.

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