

# Client Alert

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Finance and Litigation Departments

## Navigating the World Bank Group's Anti-Corruption Initiatives: Ensuring That Projects Are Not Delayed or Derailed

"In face of these trends among multilateral development banks, and the WBG in particular, parties involved in WBG-financed projects should take relevant risk factors into account throughout the life of the project and take appropriate steps to manage such risks."

The World Bank Group<sup>1</sup> (WBG) announced its latest anti-corruption initiative, the International Corruption Hunters Network, at its annual meeting last month. This effort, made up of 120 officials from 31 countries, seeks to strengthen local law enforcement capabilities.<sup>2</sup> One consequence of the global economic crisis is a renewed interest in the multilateral development banks that provide project financing for private investment in developing countries. Over the past two years, the reduction in bank capital globally and the increase in risk aversion among lenders has had an impact on project financing. For projects in developing countries this has meant an increased reliance on multilateral leaders to finance infrastructure and energy projects.

The WBG's private sector arm, the International Finance Corporation (IFC), is focused exclusively on investments in emerging markets. This year, IFC announced that its private sector investments totaled almost US \$18 billion, and an increase of 19 percent from the prior fiscal year.<sup>3</sup> The WBG's Multilateral Investment Guarantee Agency (MIGA) issued US \$1.5 billion in guarantees this fiscal year, and entered into cooperative

arrangements with regional entities to increase guarantees for private sector projects. Government performance risks can also be covered by guarantees by the WBG's International Bank for Reconstruction and Development (IBRD).

Some of the strings attached to funds from multilateral development banks include compliance with robust anti-corruption measures. In particular, parties involved in large-scale projects financed or guaranteed by the WBG should be aware of the recent developments in its anti-corruption program aimed at preventing the misuse of its investments. Proactive diligence on potential issues can avert problems with obtaining WBG-financed funds and avoid delays in projects that are underway. This *Client Alert* gives an overview of the key aspects of the WBG's anti-corruption program that have an impact on project financing.

### The Range of WBG-Financed Projects

IFC investments, for example, are spread throughout the world and across industries:

- In 2010, IFC financed a French company's plans to build a dry-

process cement plant in Karnataka, India that will help meet the region's growing demand for cement. IFC provided US \$75 million to the project while mobilizing commercial loans of €65 million from three commercial banks and parallel loans totaling €75 million from three other development financial institutions.

- This year, IFC and the European Bank for Reconstruction and Development jointly raised a total of €370 million from its own investments and commitments from various commercial banks for the reconstruction and expansion of St. Petersburg's Pulkovo airport. The syndication is Russia's first public-private partnership project financed with private money.
- Last year, IFC arranged for a US \$100 million investment in Helios Tower Nigeria Ltd. to build and maintain a network of telecommunications towers. The increased coverage is expected to help wireless operators roll out their services more economically.
- This past summer, IFC and a Norwegian industrial investor entered into a joint development agreement to provide sustainable alternatives for meeting the growing demand for electricity in Vietnam through renewable energy generation. The partners will acquire operating assets and invest in a portfolio of renewable energy investments in the country.

## Heightened Due Diligence Requirements

To unlock IFC's funding and WBG guarantees, sponsors must ensure that the proposed project has safeguards in place that address anti-corruption concerns, as well as social and environmental issues. A project team — which may consist of investment officers, engineers, lawyers and special consultants — will conduct broad due diligence on proposed projects. On the anti-corruption front, the WBG's due

diligence generally includes reviewing the structure of the project and the contractual relationships of the parties to the transaction. A key concern is clearly identifying parties involved in the project and determining if any party is being controlled by an undisclosed third party or is linked directly or indirectly to individuals holding public office.

Unresolved corruption issues will delay financing and require more in-depth investigations. In August 2010, for example, international banks delayed a decision on financing US \$875 million for oil-processing facilities in the Jubilee field in Ghana following revelations about a subcontract linked to a former state official. A consortium of banks led by the IFC called for a fresh round of due diligence after a Japanese development and engineering company revealed that it had agreed to pay fees of up to US \$5 million to a consultancy company partly-owned by the head of the Ghana National Petroleum Corporation from 1988 to 2000.

Probing the identities and backgrounds of parties involved in a WBG-financed project has never been more crucial. The WBG has ramped up efforts to collect and distribute information about corrupt schemes, as well as individuals and entities who may be involved in corruption. The WBG has launched a Preventive Services Unit in the Vice Presidency of Institutional Integrity (INT) — the WBG's anti-corruption unit — to help bank staff anticipate and guard against fraud and corruption in WBG-financed and supported projects.<sup>4</sup> The Preventive Services Unit essentially functions as a consulting group to advise operational staff of, among other things, "lessons learned" from past corruption investigations and early warning signs of corruption. This new unit recently established a Company Risk Profile Database in which it compiles INT's information on possible risks related to companies that participate in WBG projects or WBG-financed projects.<sup>5</sup>

## New Potential Tax Pitfalls

Another anti-corruption initiative at the WBG is rooting out tax abuse in project development. Private sector projects in which the WBG invests through IFC and MIGA are subject to appropriate and transparent taxation by host countries, and project sponsors must show compliance with their obligations to report income from the project proceeds. When projects are structured using offshore financial centers, the WBG will scrutinize the proposed structure to assess whether it was chosen to facilitate cross-border tax evasion, fraud or money laundering or to advance legitimate purposes. It is incumbent on the sponsor to show that offshore financial centers were used for a legitimate purpose, *i.e.*, to avoid double taxation of investments in developing countries or to provide legal infrastructure that a given host country lacks. As part of its due diligence, IFC may look at many factors, including the fiscal benefit to the developing country, relevant tax treaties and tax withholding regimes, applicable tax laws and the commitment of all the jurisdictions involved to internationally agreed tax standards.

## Ongoing Monitoring and Potential Consequences

As one would expect, after making an investment, the IFC continues to supervise the projects in its portfolios. The IFC may consult periodically with the management of the development or project companies, send field missions to visit the operations and require progress reports during project implementation. The IFC, in its capacity as lender, also has access to quarterly and annual financial statements and insurance reports, as well as the company's external auditors for the purpose of reviewing the company's accounts, operations and management letter. In some projects, the IFC requires the presence of an on-site representative during the project's construction phase. In light of its global reach, the IFC relies

in part on its resident and regional missions in-country to maintain direct contacts with various government agencies, NGOs and other parties in local financial business communities and to alert the project teams of allegations of corrupt practices in an IFC-financed project.

Acts of fraud and corruption during a project can trigger contractual provisions in the financing agreements, and may give IFC the right to accelerate its investment, cancel disbursements or terminate a facility. Additionally, allegations of fraud and corruption in projects will be subject to the WBG's sanctions process.

## Changes in the Sanctions Process

The sanctions regime among multilateral banks has new teeth. This year, in an effort to maximize the deterrent effect of the sanctions, the WBG, along with the four leading multilateral development banks,<sup>6</sup> agreed to "cross debar" firms and individuals, meaning that each bank would honor the other's debarment lists. The new cross-debarment accord is a significant step in combining resources to cut off companies involved in corrupt finances from multilateral bank-financed projects. The new agreement closes the "loophole" that had previously allowed a firm that had been debarred by one multilateral development bank to continue obtaining contracts financed by others. WBG President Robert B. Zoellick called this new message, "Steal and cheat from one, get punished by all."<sup>7</sup>

Allegations of misconduct on WBG-financed projects may be referred to the WBG's anti-corruption unit, INT. At the conclusion of the investigation, INT may submit its findings in a report and a notice of sanctions to initiate the WBG's administrative process for sanctions and debarment. An initial determination of the merits of INT's findings is conducted by an Evaluation and Suspension Officer.

Matters not settled at this level are submitted to the Sanctions Board. The individual or entity accused of misconduct has the right to appear before the Sanctions Board, present evidence and respond formally to any allegation. If there is a final decision of culpability, the Sanctions Board will determine which sanction to impose, if any. A company or an individual could expect sanctions ranging from a formal letter of reprimand to debarment under a range of conditions.

Debarment makes the party ineligible to do business with the WBG for a specified period of time. Companies have been debarred for a stated period of time, indefinitely or temporarily until certain conditions have been met. At its annual meeting, the WBG announced that in the past year, 45 firms, individuals and NGOs have been debarred from participating in bank projects for varying periods of time.<sup>8</sup> The names of all sanctioned individuals or entities are posted on a public website.<sup>9</sup>

Investigative findings can also lead to referrals to national authorities. In November 2009, INT referred findings from a forensic review to the Kenyan Anticorruption Commission, which led to opening 38 criminal investigations. The establishment of the International Corruption Hunters Network will serve to increase the number of national authorities who act as conduits for referrals from WBG investigations.

## **New Incentives for Disclosures and Settlements**

To avoid the threat of permanent or temporary debarment, companies involved in WBG-financed projects should include the WBG in a global settlement of corruption allegations. In the most well-known and significant settlement to date, Siemens A.G. wrapped up its outstanding corruption issues with the WBG last year. In addition to settling with government authorities, Siemens also acknowledged

to the WBG its past misconduct in its global business, including a pending World Bank investigation into corruption in a Russian project involving a Siemens subsidiary. The settlement included a commitment by Siemens to pay US \$100 million over the next 15 years to support anti-corruption work, an agreement of up to a four-year debarment for Siemens' Russian subsidiary, and a voluntary two-year shut-out from bidding on WBG business for Siemens AG and all of its consolidated subsidiaries and affiliates.<sup>10</sup>

Over the past few years, the WBG has developed a Voluntary Disclosure Program to allow entities and individuals (not currently under active investigation by INT) to come forward and admit to wrongdoing and wipe the slate clean. Participants in the program must commit to not engaging in further misconduct, disclose the results of an internal investigation into past misconduct on WBG-related projects and implement a comprehensive internal compliance program.

In exchange for their full cooperation, participants in the Voluntary Disclosure Program receive three significant benefits. First, participants avoid debarment for their disclosed past misconduct, preventing the sanctions that would have been entered had INT investigated the misconduct independently. Second, the participants' identities are kept confidential, avoiding the publication of their name by the WBG and preserving their reputation. And finally — and perhaps most importantly to participants — they may continue to compete for WBG-supported development activities during the process, ensuring that their firm or entity will be eligible for WBG-financing in the future.

Recently, Stephen Zimmerman, an INT Director of Operations, announced that the WBG may soon make it easier for companies that paid bribes to secure contracts on WBG-financed projects to

report their misdeeds in exchange for a milder punishment. "The World Bank is trying to create incentives for companies to come forward, and trying to be more aggressive in resolving cases," said Mr. Zimmerman.<sup>11</sup> The changes are part of the WBG's goal to create a level playing field for companies in WBG-financed projects.

In April 2010, as part of a negotiated resolution, the WBG debarred a UK publisher for six years, following an admission that the firm paid bribes in an attempt to win a contract.<sup>12</sup> In exchange for a shorter period of debarment, the company agreed to cooperate with WBG and to implement a compliance program that will be overseen by a third-party monitor. In August 2010, the WBG debarred two Albanian companies for a period of two years after both entities admitted to collusive practices during a bidding phase of a WBG-financed project. The period of ineligibility may be reduced to one year for one of the companies if it cooperates and implements a corporate compliance program that is satisfactory to the WBG.<sup>13</sup>

## Conclusion

In face of these trends among multilateral development banks, and the WBG in particular, parties involved in WBG-financed projects should take relevant risk factors into account throughout the life of the project and take appropriate steps to manage such risks.

- Sponsors and investors should conduct robust due diligence on the partners and other significant contractors involved in a project in an emerging country
- Sponsors and investors should ensure that all parties involved in a project have appropriate compliance anti-corruption systems in place, including those that aim at responding effectively to whistleblower complaints

- Sponsors should also implement stringent internal controls on the project companies to address corruption concerns specific to the region or industry involved
- Sponsors should be prepared to address the anti-corruption concerns raised by the IFC, MIGA or the IBRD before the due diligence process is initiated
- When allegations of corruption arise in a project, it is advisable to initiate an immediate review to assess the potential problems and avoid long delays or withdrawal of financing
- If corruption issues may be substantiated, parties involved on WBG-financed projects also should consider whether or not to self-disclose to the WBG, how to handle INT investigations and when to include the WBG in a global settlement of parallel proceedings.

### Endnotes

- <sup>1</sup> The World Bank Group is made up of two development institutions owned by 187 member countries — the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA). The IBRD aims to reduce poverty in middle-income and creditworthy developing countries. The IDA focuses on providing aid and assistance to the world's poorest countries. The World Bank Group also works in collaboration with the International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA). The IFC provides investments and advisory services to foster the private sector in developing countries and MIGA helps investors and lenders deal with risks by ensuring eligible projects. <http://www.worldbank.org/>.
- <sup>2</sup> Annual Integrity Report, Integrity Vice Presidency, The World Bank Group 12 (2010), available at [http://siteresources.worldbank.org/INTDOI/RESOURCES/INT\\_AnnualReport\\_web.pdf](http://siteresources.worldbank.org/INTDOI/RESOURCES/INT_AnnualReport_web.pdf).
- <sup>3</sup> Press Release, The World Bank Group, *Demand for World Bank Group Support Tops \$72 Billion as Developing Countries Face Continued Financing Gaps* (Jul 1, 2010).
- <sup>4</sup> Annual Integrity Report, Integrity Vice Presidency, The World Bank Group 12 (2008), available at [http://siteresources.worldbank.org/INTDOI/RESOURCES/INT\\_AnnualReport\\_web.pdf](http://siteresources.worldbank.org/INTDOI/RESOURCES/INT_AnnualReport_web.pdf).

- <sup>5</sup> Annual Report, Integrity Vice Presidency, The World Bank Group 34-35 (2009), *available at* [http://siteresources.worldbank.org/INTDOII/Resources/WBG\\_INTAnnualReport2009\\_web.pdf](http://siteresources.worldbank.org/INTDOII/Resources/WBG_INTAnnualReport2009_web.pdf).
- <sup>6</sup> The leading multilateral development banks include the WBG and four regional development banks, the African Development Bank, the Asian Development Bank, the European Bank for Reconstruction and Development, and the Inter-American Development Bank Group.
- <sup>7</sup> Press Release, The World Bank Group, *Cross-Debarment Accord Steps Up Fight Against Corruption* (Apr. 9, 2010).
- <sup>8</sup> Annual Integrity Report, Integrity Vice Presidency, The World Bank Group 12 (2010), *available at* [http://siteresources.worldbank.org/INTDOII/Resources/INT\\_AnnualReport\\_web.pdf](http://siteresources.worldbank.org/INTDOII/Resources/INT_AnnualReport_web.pdf).
- <sup>9</sup> The World Bank website, Procurement: World Bank Listing of Ineligible Firms, <http://web.worldbank.org/external/default/main?contentMDK=64069844&menuPK=116730&pagePK=64148989&piPK=64148984&querycontentMDK=64069700&theSitePK=84266> (last visited July 15, 2010).
- <sup>10</sup> Press Release, The World Bank Group, *Siemens to Pay \$100M to Fight Corruption as Part of World Bank Group Settlement* (Jul. 2, 2009).
- <sup>11</sup> Aruna Viswanatha, *World Bank to Ramp Up Anti-Corruption Leniency Program*, Main Justice, June 23, 2010, *available at* <http://www.mainjustice.com/2010/06/23/world-bank-to-ramp-up-anti-corruption-leniency-program/>.
- <sup>12</sup> Annual Integrity Report, Integrity Vice Presidency, The World Bank Group 8-9 (2010), *available at* [http://siteresources.worldbank.org/INTDOII/Resources/INT\\_AnnualReport\\_web.pdf](http://siteresources.worldbank.org/INTDOII/Resources/INT_AnnualReport_web.pdf).
- <sup>13</sup> Press Release, *The World Bank Group, The World Bank Group Debars Two Albanian Companies for Collusive Practice in Bidding on a World-Bank Financed Project in Albania* (Aug 9, 2010).

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