



# The Guide to Managing a Corporate Crisis

Third Edition

Editors

Sergio J Galvis, Robert J Giuffra Jr and Werner F Ahlers

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and Werner F Ahlers

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# Publisher's Note

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Latin Lawyer is delighted to publish *The Guide to Managing a Corporate Crisis*.

Edited by Sergio J Galvis, Robert J Giuffra Jr and Werner F Ahlers of Sullivan & Cromwell LLP, and containing the knowledge and experience of 50 leading practitioners from a variety of disciplines, it provides guidance that will benefit all practitioners when an unexpected crisis hits.

Corruption investigations, expropriation, industrial accidents, pandemics: corporate crises take many forms, but each can be equally dangerous for companies in Latin America. Covering the impact of political instability, the role of communications in crisis response, approaches to bribery investigations and game plans in response to financial stress, this book is designed to assist key corporate decision-makers and their advisers in effectively planning for and managing corporate crises in the region.

We are delighted to have worked with so many leading firms and individuals to produce *The Guide to Managing a Corporate Crisis*. If you find it useful, you may also like the other books in the Latin Lawyer series, including our *Guide to Corporate Compliance, and Regulators*, our online tool that provides an overview of the major regulators in Latin America.

My thanks to the editors for their vision and energy in pursuing this project and to my colleagues in production for achieving such a polished work.

# Contents

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Introduction: Effective Crisis Management in Latin America.....	1
<i>Sergio J Galvis, Robert J Giuffra Jr and Werner F Ahlers</i>	

## **Part I: Lessons from the Covid-19 Crisis**

1	Managing the Covid-19 Pandemic in Brazil: Issues and Recommendations for Directors and Officers.....	11
<i>Cleber Venditti, Paula Indalecio and Thiago Jabor</i>		
2	Covid-19 and the Impact on Corporate Governance and Compliance in Colombia.....	23
<i>Jaime Herrera Rodriguez and Oscar Tutasaura Castellanos</i>		

## **Part II: Navigating Political and Country Risks**

3	Argentina: A Legal Toolbox for an Unprecedented Crisis.....	33
<i>Mariela I Melhem, Esteban Valansi and Siro P Astolfi</i>		
4	Fire Marshals, Not Firefighters: A Different Approach to Crisis Management in Latin America .....	46
<i>Thomas F McLarty III</i>		
5	Dealing with the Challenges of Political Violence and Crime in Latin America.....	53
<i>Jack Devine and Amanda Mattingly</i>		
6	Navigating a Corporate Crisis: Managing the Risks of Downsizing in Venezuela.....	66
<i>Fulvio Italiani and Carlos Omaña</i>		
7	M&A in a Crisis-Prone Environment: Red Flags and Warning Signs in Peru .....	71
<i>José Antonio Payet and Carlos A Patrón</i>		

## **Part III: Stakeholder Relations**

8	Never Let a Good Crisis Go to Waste: The Role of Culture, Perception and Common Sense in Crisis Management .....	83
<i>Pablo Jimenez-Zorrilla and Gregorio Lascano</i>		

9	Singing from the Same Song Sheet: How Collaboration Between Legal and Communications Can Mitigate a Crisis.....	93
	<i>Paul A Holmes and Eric M Wachter</i>	
10	Crisis Management as a Tool for Approaching Shareholder Activism.....	103
	<i>Sergio J Galvis and Werner F Ahlers</i>	
11	Data Privacy and Cybersecurity: Crisis Avoidance and Management Strategies .....	113
	<i>Jeremy Feigelson, Andrew M Levine, Christopher Ford, Anna R Gressel, Stephanie Cipolla and Hilary Davidson</i>	
12	Mining Projects in Peru: Community Relations, Indigenous Rights and the Search for Sustainability.....	137
	<i>Luis Carlos Rodrigo Prado</i>	

#### **Part IV: Restructuring and Insolvency**

13	Weathering a Crisis in Brazil: Fiduciary Duties of Directors and Officers of Brazilian Companies Approaching Insolvency .....	149
	<i>Giuliano Colombo and João Guilherme Thiesi da Silva</i>	
14	Financial Distress: An Action Plan for Corporate Restructurings in Mexico .....	160
	<i>Eugenio Sepúlveda</i>	
15	United States Bankruptcy Proceedings for Latin American Corporates.....	172
	<i>Andrew G Dietderich, James L Bromley and Fabio Weinberg Crocco</i>	

#### **Part V: Anti-Corruption and Government Investigations**

16	Anti-Corruption in Latin America.....	181
	<i>James M Koukios, Ruti Smithline, Gerardo Gomez Galvis and Julian N Radzinski</i>	
17	When Good Companies Fight Against the Bad: A Practical Crisis Management Guide for Doing Business in Mexico.....	195
	<i>Leonel Pereznieta and Narciso Campos</i>	
18	Representing Individual Executives in Latin America .....	203
	<i>Mauricio A España, Hector Gonzalez, Andrew J Levander, Mariel Bronen and Yando Peralta</i>	
19	The Changing Landscape in Brazilian Investigations Since Lava Jato.....	214
	<i>Breon S Peace, Jonathan Kolodner and Lisa Vicens</i>	
20	Cross-Border Transfer Pricing Investigations and Proceedings .....	224
	<i>José Luis Fernández Fernández and César De la Parra Bello</i>	
	About the Authors.....	235
	Contributing Law Firms' Contact Details.....	255

# Part II

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## Navigating Political and Country Risks



# 7

## M&A in a Crisis-Prone Environment: Red Flags and Warning Signs in Peru

**José Antonio Payet and Carlos A Patrón<sup>1</sup>**

Cross-border mergers and acquisitions often present challenges for investors entering new markets and unfamiliar legal, cultural and political environments. For unexperienced foreign investors, entering Latin American markets like Peru can at times feel like entering a parallel reality. Objectives can often be derailed by differences in business practices and customer preferences, ill-advised regulations, an uncooperative bureaucratic system and hidden forces, such as incumbent competitors or corruption-driven interests operating from the shadows.

Crises, of course, can surface at any time and anywhere, but businesses are most vulnerable when operating in unfamiliar and thus unpredictable foreign environments. Uncertainty and information asymmetries may limit the effectiveness of standard crisis prevention and management protocols. The *Lava Jato* corruption scandal and its implications throughout Latin America and the still unknown long-term effects of the covid-19 crisis further muddy these already murky waters.

In this context, often the key to preventing a crisis and successfully managing one if it were to arise resides in retaining proper local counsel and consultants with a proven track record for integrity and experience in dealing with the complexities of the domestic markets.

In this chapter, we discuss challenges investors are likely to face in Latin America in the different phases of an M&A transaction and how they may be mitigated, with a particular focus on Peru.

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<sup>1</sup> José Antonio Payet and Carlos A Patrón are partners at Payet, Rey, Cauvi, Pérez Abogados.

## **Due diligence**

### **Counterparty due diligence**

The most relevant aspect of diligence when looking into a transaction is by far the screening of the counterparty and its beneficial owners. No contractual structure, remedy, choice of law or sophisticated dispute-resolution mechanism will protect an investor from a noxious counterparty or beneficial owner.

Although contractual provisions may afford a certain level of comfort, a foreign investor should always keep in mind that a home-field advantage can be heavily leveraged by a shady counterparty. For instance, civil or commercial matters, even if contractually submitted to foreign law, can be criminalised before local courts by unscrupulous attorneys.

Typical red flags such as bribery, corruption, fraud and links to money laundering may be insufficient to identify a potentially toxic counterpart. In many smaller markets, the most valuable intangible is a solid reputation and good standing among the local business community, which tends to be a close-knit group.

### **Government relations**

The nexus between business and politics is an axiomatic reality. It not only varies depending on the political and economic climate of a country but also affects the various industries in multiple ways.

Latin America offers a broad business-politics spectrum, from state capitalist systems, to populist interventionist state systems, to open economy democracies. While dissimilar in nature, they all share to some degree the unfortunate common strand of corruption and privileges.

Due diligence to determine the personal connections and networks in the political environment may help identify regulatory risks for foreign investments. Compliance protocols when contacting or dealing with government officials should not be taken lightly, but rather strictly adhered to.

In general, cosy relationships between the target and government officials or regulators should be thoroughly scrutinised, since they could be a consequence of favours or irregular, non-transparent relationships. Past government attitudes towards a company are not necessarily a useful tool for predicting future conduct, particularly when a change in ownership is involved. A lax regulator or agency may turn into a stringent or even hostile supervisor upon a change of ownership.

### **Tax administration**

Tax planning is essential. However, for these purposes, one should not assume that the tax administration will necessarily act reasonably. Latin America has an unfortunate track record of abusive and formalistic tax administrations. The Peruvian National Superintendency of Tax Administration, for instance, is generally honest, but very aggressive and extremely formalistic. Increased government spending and decreased tax revenues during the covid-19 crisis will probably further negatively influence the tax administrations' attitudes and practices in the near future.

## **Dealing with labour**

The complexity and rigidity of labour regulations are often fertile ground for unforeseen risks, often related to profit-sharing regulations, overtime work, and social benefits and pension fund dues, among others. Statutes of limitations in Latin America may well exceed standard share purchase agreement (SPA) survival for indemnity provisions. For instance, in Peru, the statute of limitations can run to four years after the employee's contract has been terminated, which in practical terms could result in liabilities decades after an acquisition. Thus, hidden labour liabilities may be significant.

Increased scrutiny from labour authorities in the aftermath of labour cost reduction strategies deployed during the covid-19 crisis is to be expected.

While an investor will value finding a harmonious union, special attention should be paid to the relationships established by prior ownership with collective bargaining leadership, as calm waters may be the result of payoffs or other non-ethical negotiating strategies.

## **Litigation**

A target company with a high degree of success on material litigation matters may be a warning sign. Companies that are willing to 'play with fire' may deploy unethical practices to guarantee favourable decisions. Changes in ownership and, consequently, in litigation methods, may result in adverse outcomes. Accordingly, diligence on the attorneys regularly retained by the target company may provide valuable insights and help anticipate issues down the road.

## **Antitrust**

High-profit margins, stable market shares or low levels of investment in innovation may be seen by buyers as opportunities for greater returns on their investments. They may also signal antitrust concerns.

Similarly, the pressure to maintain sales or recover revenue lost during the covid-19 crisis may result in lax compliance and could pose potential risks. For instance, several cartels sanctioned in Peru during the past decade have a connection to the 2008 financial crisis.

A standard due diligence review may not identify anticompetitive practices that are, by nature, secretive. It is not uncommon for investors to unwittingly acquire a party to a cartel and, if post-closing diligence is not deployed, only learn of the problem after an authority carries out a dawn raid on their business.

There has been a significant increase in the level of antitrust enforcement in the region in recent decades. Local authorities are not only knowledgeable and experienced but are known for deploying sophisticated forensic methods and leveraging their substantial fining capabilities. In certain sectors, particularly consumer goods, fallout from antitrust proceedings may significantly damage brand value and should not be taken lightly.

The statute of limitations for antitrust violations and antitrust damages may be lengthy. In Peru, for instance, the statute of limitations is five years from the date the conduct ceases for administrative penalties, and two years from the date that administrative procedures are concluded for damages.

## **Contracting**

### **Choice of law and forum**

In countries that allow for it, like Peru, it is rather common for larger M&A transactions to be submitted to foreign law and forum. New York State law is especially common as the choice of law. Increased political risks are impacting and extending the use of these types of provisions. In Peru, for instance, one of the collateral effects of the *Lava Jato* investigations has been an increasing outward-bound trend in choice of law and forum in medium and smaller-sized transactions.

Similar trends are observed in Peruvian arbitration provisions. Although in the past, the institutional stability of domestic arbitration centres made local arbitration a viable option for certain size transactions, the risks associated with having local courts handling annulment procedures and the fallout of corruption scandals linking some arbitrators to secret payrolls of construction companies have investors considering alternative choices of forum. Thus, international arbitration provisions with a foreign seat are fairly common in large transactions.

### **Anti-corruption representations and warranties**

Anti-corruption representations and warranties have not only become standard to meet the requirements of the US Foreign Corrupt Practices Act and the UK Bribery Act but have acquired critical importance for investors in the post-*Lava Jato* Latin American reality. Ample and unqualified representations have become the norm. A breach of these types of declarations may have catastrophic consequences and should, therefore, always be characterised as fundamental, not subject to caps and with longer survival periods. Further, closing should be conditioned on the absence of any event related to corruption.

### **International investment agreements**

International investment agreements (IIAs), when available, are of the utmost importance to mitigate risks in uncertain environments and it is imperative to take them into account when planning how investment vehicles are structured. Countries like Colombia, Costa Rica, Chile and Peru are at the vanguard, having subscribed to the most bilateral investment treaties (BITs) and free trade agreements (FTAs) in the region. Attention should be paid to these agreements, since, while similar in structure, not all IIAs were created equal. BITs and FTAs tend to be somewhat heterogeneous since their provisions reflect the contracting parties' specific interests. Hence, the inter-relationships between the various provisions of these agreements should be thoroughly examined.

Of particular relevance is the characterisation of an 'investment' covered in these agreements, which can often be narrowly defined. Provisions related to national treatment and as well as fair and equitable treatment, investor-state dispute settlement mechanisms, such as the International Centre for Settlement of Investment Disputes, expropriation, 'umbrella clauses' and most favoured nation provisions, among others, should be scrutinised.

## Government approvals

The fallout from the *Lava Jato* investigations has undoubtedly impacted private sector interactions with government officials. If previously many Latin American countries had a reputation for an abundance of red tape and underqualified public servants, an unprecedented combination of criminal actions, audits and independent journalistic investigations have led to a perfect storm that often results in bureaucratic paralysis. Furthermore, government approval should not be taken as final since risks of inconsistent government behaviour is always present.

The case of the Chaglla hydroelectric power plant sold by Odebrecht to China Three Gorges (see below) is illustrative. After many months, the Peruvian government ultimately approved the transfer and allocation of the purchase price (including a portion thereof that would be reimbursed to Odebrecht), only to threaten to backtrack on the release of funds to Odebrecht a few months after, when the transaction had been already closed and the price paid. Another interesting example is the Las Bambas copper mining project, where, upon the sale of the project company by Glencore-Xstrata to MMG – the China Minmetals Australian subsidiary – the government authorised the company not to use a mineroduct for the transportation of concentrate to the coast (as originally envisaged in the project) and to instead employ road transportation with trucks running over dirt roads crossing the Andes plains. When the mine started operations, road transport proved a focus of social conflict and an important risk factor for the operation of the mine, as the roads could be easily blocked by *campesinos* to support their claims against the mining company. Notwithstanding government permits, the use of the road instead of the mineroduct created a significant contingency in a mine producing 2 per cent of the world's copper output.<sup>2</sup>

## Post-closing horror stories

Due diligence and contract techniques can only do so much. It is not uncommon after the closing of an acquisition, and in Peru far too frequent, for skeletons to begin to crawl out of the woodwork and for a crisis to erupt. A couple of situations that have occurred with two urban road concessions granted by the Municipality of Lima after the *Lava Jato* scandal broke out in Peru make good cautionary tales:

- In June 2016, Brookfield and Sigma (a Peruvian infrastructure fund) acquired a controlling interest in Rutas de Lima, a company operating an urban road concession in Lima, granted by the Municipality of Lima.<sup>3</sup> An Odebrecht subsidiary maintained a 25 per cent stake in the concessionaire as the qualified operator of the concession.
- In August 2016, Vinci Highways acquired 100 per cent of LAMSAC, the concessionaire of Línea Amarilla (also called Via Parque Rimac), another road concession in the city of Lima. The concession had originally been granted to the Brazilian construction company OAS.
- In June 2015, Mr Marcelo Odebrecht was arrested in Brazil on corruption charges in the *Lava Jato* scandal.

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<sup>2</sup> *Gestión*, 28 March 2019.

<sup>3</sup> *Semana Económica*, 24 June 2016.

- In August 2015, Mr José Aldemário Pinheiro Filho, former CEO of OAS, was sentenced in Brazil for money laundering, organised crime and corruption.
- In November 2016, the US Department of Justice announced that Odebrecht and Braskem had agreed to pay a US\$3.5 billion fine as a result of corruption actions. The Department of Justice's press release mentioned several Latin American countries, including Peru. The release specifically indicated that bribes for US\$29 million had been paid in Peru.<sup>4</sup>
- In May 2019, Susana Villarán, the former mayor of Lima, under whom the concession for Rutas de Lima had been granted and the Linea Amarilla concession had been amended, recognised that Odebrecht had contributed US\$3 million and that OAS has contributed US\$7 million to fund her political campaign against an action promoted to remove her from office.<sup>5</sup> Ms Villaran is currently in preventive prison in Lima. After the news of the Odebrecht and OAS payments to the former mayor's campaign were made public, marches and protests were carried out in Lima against the tolls being collected in the Rutas de Lima and Linea Amarilla concessions.<sup>6</sup>
- In July 2019, the current mayor of Lima, Mr Jorge Muñoz, announced that, as a result of negotiations entered into between the municipality and Rutas de Lima, toll increments would be suspended until all pending works under the concession were concluded and that the concessionaire had accepted to reform certain designs to improve the concession. Mr Muñoz also announced that no agreement had been reached with Vinci, and that as a result the municipality would take all legal actions required for annulment of the concession agreement. The mayor stated the following: 'With the new owners of LAMSAC, Vinci, there has been no signal of them having understood the just claims of the people, in addition to what is being discovered day after day.'<sup>7</sup>

There is no clear legal position in Peru regarding the standing of the concession agreements executed as a result of corruption or in circumstances where corruption is claimed to have occurred. The Peruvian Civil Code, as is common in civil law countries, establishes that a contract is null and void if it is contrary to public policy. This provision could eventually be used by a court or arbitration tribunal to declare a concession agreement executed as a result of corrupt practices null and void. In a recent case in Colombia, an arbitration tribunal declared the nullity of the Ruta del Sol concession agreement as a consequence of corruption claims.<sup>8</sup> Since the statute of limitations for annulment actions against a contract executed in violation of public policy lapses only after 10 years in Peru, this contingency will be open for a long period – much longer than normal SPA survival periods.

Until now, none of the concession agreements entered into by entities involved in the *Lava Jato* scandal has been declared null or annulled by the judiciary or by an arbitral tribunal in Peru, nor have any of these agreements been formally repudiated by the state by cause of corruption. For example, the concession agreement for the Gasoducto Sur Peruano

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<sup>4</sup> Department of Justice, Office of Public Affairs, 21 December 2016.

<sup>5</sup> *Gestión*, 10 May 2019.

<sup>6</sup> *Exitosa*, 19 May 2019.

<sup>7</sup> *Gestión*, 24 July 2019.

<sup>8</sup> *El Confidencial*, 7 August 2019.

project, led by Odebrecht, which was cancelled by the Peruvian state on June 2017, was terminated as a result of a breach of the agreement, because the concessionaire failed to reach financial closing at the maximum date established in the contract.<sup>9</sup> On the same note, the concession granted to build and operate the Chinchero airport in Cusco was terminated by the government because of ‘public interest’ concerns under the unilateral termination provisions established in the same concession agreement, and not pursuant to allegations of corruption.<sup>10</sup> Even in the LAMSAC case described above, the concession contract is still in force and the concessionaire is operating the concession.

Nonetheless, in the aftermath of the *Lava Jato* scandal, after the US Department of Justice plea bargain agreement with Odebrecht was made public, the contingency created by the possibility of annulment of concession contracts executed as a result of corruption became an intolerable risk for most investors.

In this context, in March 2018, the Peruvian government issued Law 30737, which had an objective to allow projects in the hands of entities involved in the *Lava Jato* scandal to be transferred to new operators, while at the same time guaranteeing the rights of the Peruvian state to receive just compensation for the damage caused by corruption. The law establishes that any transfer of assets of companies sentenced for corruption or that have recognised corruption acts, requires prior approval of the Peruvian government and that the proceeds of the sale be applied in part to cover compensation for damage caused by the acts of corruption. If the procedure is followed, the purchaser will acquire the assets ‘free and clear’ and not be liable as a result of any prior corruption acts related to the concession.

Notwithstanding, Law 30737 has not necessarily operated as it was intended. The only relevant case in which the law has been applied to a transfer is the sale of the Chaglla hydro power plant by Odebrecht to China Three Gorges in April 2019 for a total value of US\$1.4 billion.<sup>11</sup> The transaction and the application of the proceeds of the sale were approved by the government under Law 30737, after a long and cumbersome proceeding. The terms approved included that part of the consideration for the sale (approximately US\$158 million) had to be returned to Odebrecht, after the payment of taxes and the funding of a trust account for compensation to the Peruvian government.

After the sale closed and the Peruvian government received the proceeds from the sale and the right of Odebrecht to the reimbursement of part of the consideration was triggered, a public debate about whether Odebrecht should be entitled to receive part of the proceeds broke out. Even the president of Peru expressed his opinion on the matter, stating before the media that he was against giving back any funds to Odebrecht: ‘The damage is so large that no restitution should be made,’ he said.<sup>12</sup> However, both the government attorney and the prosecutor have expressed that the funds should be returned to Odebrecht, in compliance with the plea agreement they had reached with Odebrecht. The matter is now before the judiciary, and a decision is expected shortly.<sup>13</sup>

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9 Resolución Suprema N° 004-2017-EF, of 15 February 2017.

10 *La República*, 13 July 2017.

11 *Gestión*, 25 April 2019.

12 *Perú* 21, 2 August 2019.

13 *El Comercio*, 19 October 2019.

It is also important to consider that Law 30737 is a double-edged sword, as its provisions are not only applicable to the entities directly involved in the corruption crime, but also to certain affiliated entities. This has caused, for example, Rutas de Lima to be considered subject to these provisions after the acquisition of a controlling stake by Brookfield and Sigma, because of the 25 per cent participation retained by Odebrecht.<sup>14</sup> In particular, by acquiring more than 10 per cent of the shares of an entity already included in 'Group I' of Law 30737, an entity or group can get 'pulled in' into the restrictions established by this law.

Peru does not have a general system of leniency for criminal corruption offences. Although Law 30737 allows public prosecutors to enter into plea agreements in very general terms, it is not clear what the scope of these agreements is and whether they may be entered into outside the scope of Law 30737.

However, Law 30424, as amended by Legislative Decree 1352, establishes criminal liability of legal entities (administrative liability), pursuant to which a legal entity (including a corporation), may be liable for crimes of corruption, money laundering, etc., committed by their officers and directors in certain circumstances. Thus, a corporate target may be liable for past criminal offences, which can be a significant additional contingency. The statute includes a provision establishing that, upon a merger or a spin-off, the absorbing entity will not be liable for offences that occurred before the transaction, provided a proper due diligence process was undertaken. However, this provision does not apply to a simple acquisition of shares that is not followed by a merger or spin-off. In addition, as a general matter, an adequate compliance and prevention system implemented before the offence was committed, will serve as an absolute defence to corporate criminal liability. However, from a corporate law perspective, directors of a corporation can be held liable for damages arising from illegal acts committed by their predecessors if the directors have knowledge of these acts and fail to report them to the shareholders.

## **Final thoughts**

Although it is impossible to design a one-size-fits-all road map to navigate the myriad situations that may arise when a crisis erupts as a result of pre-existing situations in a company following an acquisition, some fundamental recommendations may be useful.

Pre-acquisition due diligence is often imperfect because of asymmetries of information and time constraints. In particular, when offences such as corruption or cartels are involved, it is typically extremely difficult to obtain candid disclosure, either because top-level management or shareholders of the target may not have been fully aware of the situation, or because they were complicit. For this reason, in-depth post-acquisition due diligence is extremely useful.

Although there is no general leniency for criminal offences system in Peru, there are procedures in place that may allow an investor to come forward if an offence is discovered.<sup>15</sup> In the case of both criminal and regulatory offences, authorities will generally be willing

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<sup>14</sup> See 'Listado de Sujetos Comprendidos en la Ley N° 30737', [www.minjus.gob.pe/wp-content/uploads/2018/09/001\\_RELACION-CATEGORIA-1\\_SET2018.pdf](http://www.minjus.gob.pe/wp-content/uploads/2018/09/001_RELACION-CATEGORIA-1_SET2018.pdf).

<sup>15</sup> For example, leniency from administrative fining procedures is, however, available for cartel cases.



to engage transparently and honestly in a process where an investor comes forward with evidence and seeks to preserve the value of the investment. However, this process should not be undertaken without the advice of local reputable and experienced counsel.

Procedures often move slowly in Latin America, particularly in Peru. Public officials may hesitate to make difficult decisions and prefer to postpone taking action. It is important to be patient and persistent. Things may take longer than in more developed markets, but they can be done legally and transparently.

Above all, of course, investors should avoid shortcuts, special favours or deploying non-transparent remedies. Reputable, trustworthy, competent, experienced and ethical counsel is one's best guide out of these labyrinths.

# Appendix 1

## About the Authors

### **José Antonio Payet**

Payet, Rey, Cauvi, Pérez Abogados

Mr Payet is founding partner of Payet, Rey, Cauvi, Pérez Abogados and specialises in general commercial law, mergers and acquisitions and financial transactions. He is also a professor of law at the Pontifical Catholic University of Peru.

He has extensive experience in cross-border and domestic transactions, as well as financing and securities work. He has participated in several of the most important corporate finance transactions in Peru, including acquisitions and divestitures of public and privately held companies, securities offerings, securitisations, traditional banking and project finance lending.

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Mr Patrón is a partner at Payet, Rey, Cauvi, Pérez Abogados, specialising in antitrust, regulatory law, telecommunications, energy, corporate law and civil law. He is also a professor of law at the Pontifical Catholic University of Peru.

He has extensive experience in both the analytical and regulatory issues related to Peruvian competition law, covering a wide variety of industries. He has participated in leading antitrust cases, including the most emblematic price-fixing investigations carried out in Peru (i.e., tissue paper, shipping conferences, PCC, LPG, drug stores).

Prior to joining the firm, he was a visiting associate at Sullivan & Cromwell LLP in New York. He has also been a senior associate at Andersen Legal, and has held the positions of technical secretariat for the Consumer Protection Commission, adviser for the Economic Studies Department, assistant clerk to the Tribunal for the Defence of Competition and

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Corruption investigations, expropriation, industrial accidents, pandemics: corporate crises take many forms, but each can be equally dangerous for companies in Latin America.

Published by *Latin Lawyer*, edited by Sergio J Galvis, Robert J Giuffra Jr and Werner F Ahlers of Sullivan & Cromwell LLP, *The Guide to Managing a Corporate Crisis* is designed to assist key corporate decision-makers and their advisers in effectively planning for and managing corporate crises in the region. Fifty leading practitioners from a variety of disciplines have contributed their knowledge and insights from their experience.

Covering the impact of political instability, the role of communications in crisis response, approaches to bribery investigations and game plans in response to financial stress, this book provides guidance that will benefit all practitioners when an unexpected crisis hits.

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