

Corruption Investigations in the Peruvian Infrastructure Industrial Sector: Background, Effects and Considerations to Protect Foreign Creditors

By RENZO AGURTO ISLA and PATRICIA CASAVARDE RODRIGUEZ



Corruption has always been a sensitive issue when doing business in Latin America. Recently, the impact of the corruption scandal known as *Lava Jato* (Car Wash) has rippled across several countries in the region. Peru has not been an exception to this reality. In December 2016, Odebrecht S.A., the Brazilian engineering and infrastructure construction firm, admitted to the U.S. Department of Justice that it paid US\$ 29 million in bribes to Peruvian officials between 2005 and 2014 in exchange for construction projects with the Government. Since then, the Peruvian Public Ministry has commenced several investigations against several foreign and local engineering and infrastructure construction companies, former managers and directors of such companies and former Peruvian officials. Those criminal investigations include Odebrecht, Camargo Corrêa S.A., OAS S.A. and UTC Engenharia S.A., among others.¹

The Government's executive branch² responded to the *Lava Jato* scandal by issuing Legislative Decree Nos. 1341 and 1352 in January 2017, which introduced severe administrative sanctions towards companies convicted of corrupt practices and money laundering. Furthermore, in February 2017, the Government's executive branch issued Urgency Decree No. 003-2017 to prevent the sale of rights and assets of companies convicted of such crimes. Such Urgency Decree established restrictions for certain companies, including (i) the restriction on the transfer of their funds abroad; (ii) the required prior authorization from the Ministry of Justice in case of a transfer of rights and/or assets³; and (iii) the withholding of payments that public entities owe to the debtor.

The companies falling within the scope of Urgency Decree No. 003-2017

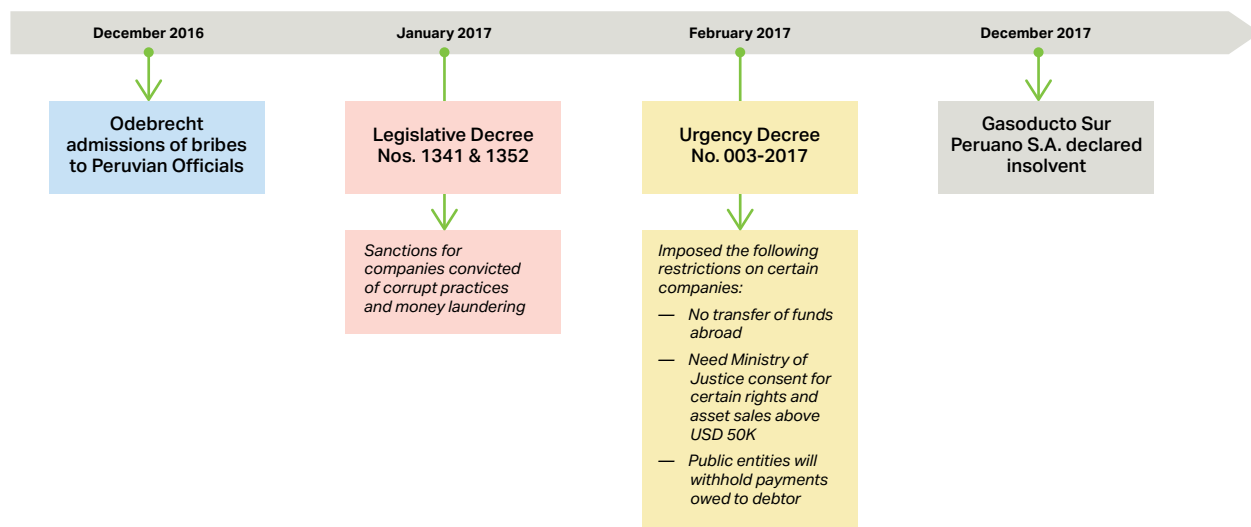
1. Entities convicted, or whose officials or representatives have been convicted, in Peru or abroad, by means of a consensual or enforceable judgment for crimes against the public administration or money laundering or equivalent crimes;
2. Entities that, directly or through their representatives, have admitted and/or acknowledged the commission of any of the crimes described above before any competent Peruvian or foreign authority; or
3. Entities that are "related" (such as this term is defined in Urgency Decree No. 003-2017) to those entities mentioned in (1) and (2) above.

All these measures have severely impacted the stakeholders of companies in the infrastructure industrial sector. For example, Legislative Decree No. 1341, which amended the Peruvian State Procurement Law (*Ley de Contrataciones con el Estado*), forbids foreign and domestic entities to contract with the Government if they have been convicted in Peru or any other jurisdiction of corruption-related crimes and/or money laundering. The same restriction applies if representatives of such entities disclose the commission of such crimes under a leniency program in any jurisdiction. At the moment, the implications of Legislative Decree Nos. 1341 and 1352 and Urgency Decree No. 003-2017 only reach Odebrecht⁴. However, an amendment to Urgency Decree No. 003-2017 is currently under review,⁵ which may bring in other infrastructure companies within the decree's scope and/or modify other relevant aspects of such Urgency Decree.

The foregoing situation, including the fact that there is another ongoing criminal investigation against major local companies in the infrastructure sector accused of allegedly colluding to secure infrastructure local projects,⁶ has created an imminent risk of a severe paralysis in this sector and, therefore, an interruption of the infrastructure supply payment chain.⁷ In our experience, this may trigger the insolvency of some companies that have a direct or indirect relationship with the infrastructure industrial sector.

According to the Ministry of Economy and Finance of Peru (MEF for its acronym in Spanish), the *Lava Jato* scandal has already negatively affected the appetite for private investment and the generation of jobs and the domestic consumption. According to MEF statistics, such scandal, together with the

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natural phenomenon “*El Niño Costero*” that also affected Peru last year, has generated a negative impact of 1.5 percent of Peru’s GDP in 2017, as compared to Peru’s GDP in 2016.⁸ According to a recent statement made by the MEF, this is a systemic issue that could trigger a severe paralysis in different sectors of the Peruvian economy.⁹

In fact, in December 2017, the Insolvency Commission (the “**Commission**”) of the National Institute for the Defense of Competition and the Protection of Intellectual Property (“**INDECOPI**”), which is Peru’s insolvency authority and a public specialized agency under the executive branch, announced in the Peruvian official gazette that Gasoducto Sur Peruano S.A. (“**GSP**”), former concessionaire of a 1,100-kilometre pipeline project in the south of Peru overseen by a consortium group that included Odebrecht, Spain’s Enagás S.A. and Peru’s Graña y Montero S.A.A., has been declared insolvent. Unfortunately, this may not be the first nor the only insolvency case in the near future. As its well known, the insolvency of GSP is closely related with the *Lava Jato* scandal, since financing for the project dried up in the wake of its corruption revelations. The banks backing the project refused to provide further loans unless Odebrecht withdrew, but the Brazilian company was unable to find a buyer for its 55% stake in GSP. According to the latest information, 31 creditors have presented their proof of claims before the Commission.¹⁰ Currently, such claims are under evaluation. Once this stage is completed, the Commission will call for a creditors’ meeting.

The case of GSP is an example of what may happen in the following months to other companies in this sector and, in light of this situation, it is important for foreign investors to understand the main features of an insolvency proceeding in Peru as well as important rights of creditors party to such proceeding.

Peruvian Insolvency Proceeding Main Features

The general regime for insolvencies and reorganizations in Peru is set by Law No. 27809 (the “**Insolvency Law**”) and has an administrative nature, as the insolvencies are carried out before INDECOPI, through its Commission in the first instance and then through its Tribunal in the second instance, deals with insolvency proceedings. Peruvian judicial courts play a complementary role (e.g., reviewing at a request of a party INDECOPI’s decisions and analyzing the transactions that may be clawed back).

Scope:	Business entities and individuals that carry out business activities, in each case domiciled in Peru.
Types of insolvency proceedings:	Preventive insolvency proceeding and ordinary insolvency proceeding. The latter may be either voluntary or involuntary. Involuntary ordinary proceedings are confidential until the Bar Date (as defined below).
Who can commence a preventive insolvency proceeding:	Only the debtor.
Who can commence an involuntary ordinary proceeding:	One or more creditors that maintain a claim before the debtor that exceeds 50 tax units, ¹¹ and such amount has been due for more than 30 calendar days.
Debtor’s options:	The debtor may opt for: <ul style="list-style-type: none"> — paying the total amount of the claim; — making an offer to pay the total amount of the claim; — opposing the existence, ownership, enforceability or amount of the claim; or — accepting the filing to commence the insolvency proceeding.
Bar Date:	When the Commission announces in the Peruvian official gazette that the debtor has been declared insolvent. According to the Insolvency Law, the term for the Commission to determine the Bar Date is 90 business days. However, in our experience, depending on the complexity of the case, it might take longer.
Automatic stay:	Once the automatic stay is in effect, then from the Bar Date: <ul style="list-style-type: none"> — all the debtor’s obligations comprised within the insolvency proceeding are stayed; and — all foreclosure proceedings for collection as well as injunctions against debtor’s estate are stayed. This does not include assets of a debtor that are secured by the guarantee of obligations of third parties (originated before the Bar Date), which can be foreclosed at the expiration of the obligation¹².
Corporate Groups:	The Insolvency Law does not recognize corporate group insolvency. That is, the law regulates the insolvency proceedings on a company by company basis and does not include any regulation relating to proceedings covering more than one legal entity or entitling creditors of insolvent companies or the companies themselves to include others.

Transactions That May be Clawed Back

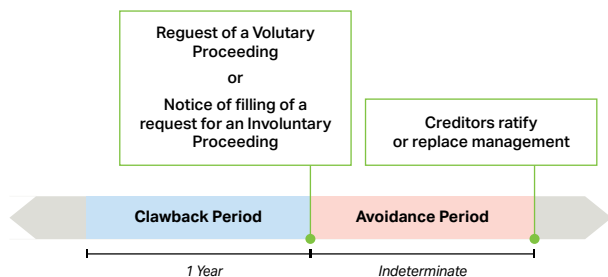
A very important aspect that creditors should bear in mind is that actions taken by some of the debtor companies may be placed under scrutiny.

In this respect, once the debtor is given notice of a creditor petition to commence an involuntary insolvency proceeding, all actions taken by management: (i) during the prior year (“**Clawback Period**”) and, (ii) from that date on and until the date the creditors ratify or replace debtor’s management (“**Avoidance Period**”), could be questioned. If the transactions (i.e., any transfer or sale of assets) meet certain requirements as detailed below, they may be voided by a Peruvian judicial court.

— **Clawback Period.** The Clawback Period covers all actions or transactions, whether for consideration or not, that:

- Have been taken by an insolvent debtor during the previous year from the notification to commence the insolvency proceeding;
- Have a “negative effect” on the net worth of the insolvent debtor. (There is no consensus on the definition of what “negative effect” means. In our opinion, it occurs when there is an impairment, deterioration, loss or prejudice in the debtor’s estate and a negative impact on the creditors’ ability to obtain payment of their claims.); and
- Are not in the “ordinary course of business.” There is no consensus on the definition of what “ordinary course of business” means. In our opinion, this concept shall be interpreted as widely as possible. Therefore, not every action or transactions taken by the insolvent debtor that goes beyond its corporate purpose (*objeto social*) shall be considered out of its ordinary course of business.

— **Avoidance Period:** Some actions taken by an insolvent debtor once the Clawback Period concludes and until the date when creditors ratify or replace the management may also fall under scrutiny. Analyses should be done on a case by case basis.



Any creditor who is planning to deal with the debtor companies should bear in mind the risk that the Clawback Period and Avoidance Period can implicate. As we discussed previously,¹³ in such cases, the corresponding legal due diligence that creditors conduct should include within its scope the financial situation of the debtor.

Proof of Claims

Any claim originated before the Bar Date will be considered a pre-publication claim. Only pre-publication claims are subject to the rules under the Insolvency Law, INDECOPI’s jurisdiction and the terms and conditions of the reorganization plan or liquidation agreement.

— **Allowed claims:** Creditors must file a proof of claim before INDECOPI within 30 business days from the Bar Date to be considered allowed creditors. Only those creditors can vote in the creditors’ meeting. Allowed claims will be paid before non-allowed claims either in a reorganization or liquidation.

— **Support of claims:** For the recognition of such claims, the creditor must present every documentation that supports the creditor’s claim, such as invoices, agreements, among others.

— **Foreign creditors:** In Peru foreign creditors have the same rights as national creditors regarding a request for the commencement of an insolvency proceeding and their participation therein. There are no special proceedings, impediments or protections applicable to foreign creditors.¹⁴

The Creditor’s Meeting and The Rights of Creditors with “Allowed Claims”

The creditors’ meeting plays a key role within an insolvency proceeding. Indeed, in a reorganization process, the creditors’ meeting replaces the shareholders’ authority so that they are allowed to designate the company’s management, approve the debtor’s restructuring plan and its amendments, modify by-laws and even to approve any merger of the debtor. Likewise, in a liquidation process, the creditors’ meeting will have to designate a liquidator (who must be registered before INDECOPI), approve a liquidation agreement and decide if the debtor can carry out business during the liquidation as a going concern.¹⁵ Every creditor with “allowed claims” can attend and participate in the creditors’ meeting. The voting power of such creditors is determined by their percentage in relation to the total amount of allowed claims. However, it is important to consider that there are certain matters (e.g., the restructuring plan, the liquidation agreement) that require specific quorum and majority for its approval.

Key Indicators – Peru Insolvency Regime

Experience Level: Limited established precedents of successful in-court restructurings or significant cultural resistance to resolution of insolvency through court proceedings

KEY PROCEDURAL ISSUES

Can bondholders/lenders participate directly (i.e., do they have standing to individually participate in a proceeding or must they act through a trustee/agent as recognized creditor?)	Yes ¹⁶
Involuntary reorganization proceeding that can be initiated by creditors?	Yes
Can creditors propose a plan?	Yes
Can a creditor-proposed plan be approved without consent of shareholders?	Yes
Absolute Priority Rule?	Yes ¹⁷
Are ex parte proceedings (where only one party participates and the other party is not given prior notice or an opportunity to be heard) permitted?	No
Are corruption/improper influence issues a common occurrence?	No
Viable prepackaged proceeding available that can be completed in 3-6 months	No
Secured creditors subject to automatic stay?	Yes
Creditors have ability to challenge fraudulent or suspect transactions (and there is precedent for doing so)	Yes
Bond required to be posted in case of involuntary filing or challenge to fraudulent/suspect transactions?	No
Labor claims can be addressed through a restructuring proceeding	Yes
Grants super-priority status to DIP financing?	No
Restructuring plan may be implemented while appeals are pending?	Yes
Does the restructuring plan, once approved, bind non-consenting (or abstaining) creditors?	Yes
Does the debtor have the ability to choose which court in which to file the insolvency proceeding (or is it bound to file where its corporate domicile is)?	No
Other significant exclusions from automatic stay?	Yes ¹⁹
Prevents voting by intercompany debt?	No
Strict time limits on completing procedure?	No
Management remains in place during proceeding?	Yes ²⁰

Protection Mechanisms for Investors

Once a creditor has identified that the debtor is in a difficult financial situation, the creditor may consider to protecting its exposure by implementing some of the following mechanisms.

In our experience, some of the most important mechanisms for creditor's protection are the insertion of adequate representations and warranties within the credit agreement (or any other similar or related agreement), and the sanction of any breaches of the debtor with high penalties. The representations and warranties could be complemented by, among others, the imposition of a debtor's obligation to periodically report its debts that may expire in the near future.

Another mechanism for creditor's protection in such contexts, but certainly much more expensive, is the constitution of a trust into which the debtor transfers the amount agreed as penalty in case of breach of the mentioned representations and warranties. The benefit of the latter mechanism of protection is that in case an insolvency is commenced against the debtor; the assets included in the trust will not be considered as part of the insolvency estate.

Finally, creditors may also consider the inclusion of third parties as guarantors. Pursuant to Insolvency Law, if eventually an insolvency is commenced against the debtor, the creditor will have the chance to directly collect its claims against such guarantors.

Protection Mechanisms

- Enhanced protections in Credit Agreements
- Bankruptcy remote trust for pre-agreed penalty awards
- Third party guarantors

Conclusions

The *Lava Jato* scandal has had an important impact on players, big and small, within the infrastructure industrial sector of Peru. Based on our experience, this may trigger the insolvency of some companies that have a direct or indirect relationship with the infrastructure industrial sector. In fact, the insolvency of GSP shows a situation that may be reflected in some other companies.

In this regard, it is important for any creditor (especially foreign creditors who may not be familiar with Peruvian Insolvency Law) to bear in mind its rights within an insolvency proceeding and several aspects that shall be considered in case they are willing to become creditors of one of those companies. As

mentioned, transactions in such contexts should be assessed after evaluating the risks and implementing adequate mechanisms for protection in order to mitigate them. ■

- Information obtained from the digital investigative journal "Ojo Público" (<https://ojo-publico.com/>).
- The Peruvian Congress authorized the executive branch to legislate in the prevention and fight against corrupt practices, among other matters.
- This restriction is applicable for anyone who intends to acquire, under any title, any asset or right of any of the companies falling under the scope of the Urgency Decree No. 003-2017, as well as the shares or other securities representing rights of participation issued by such companies, even when these assets, rights, actions or values have been transferred to a trust or under other similar mode.
Furthermore, the Ministry of Justice excluded any transfer with a book value under USD 50K from the scope of this restriction.
- The Ministry of Justice of Peru has issued a list that only includes Odebrecht related companies within the scope of Urgency Decree No. 003-2017. To access such information, enter the following link: <https://www.minjus.gob.pe>.
- In February 2018, the Government's executive branch presented a draft of Law No. 2408-2017-PE before the Peruvian Congress. To date, such proposed law is under review.
- This ongoing criminal investigation is known in the media as "El Club de la Construcción".
- According to Odebrecht creditors' association (services and products providers), 169 out of 450 providers have gone out of business. See the following article from the Gestión: <https://gestion.pe/economia/empresas/caso-odebrecht-deuda-constructora-proveedores-suma-s-80-millones-227084>.
- "Informe de actualización de proyecciones macroeconómicas", published by MEF on April 30, 2017.
- Statement made by Claudia Cooper, Minister of MEF on January 30, 2018 to "RPP noticias": "this is one of the priorities of the economy portfolio. It is very complicated because we are talking about a systemic issue and not just one or two infrastructure companies. Approximately \$/ 30,000 millions in public investment projects that have not been awarded yet, could be paralyzed".
- Based on publicly available information, the Bank of Tokyo-Mitsubishi, Intesa Sanpaolo, Sumitomo Mitsui Banking Corporation, Banco Bilbao Viscaya, Natixis, Odebrecht related companies and the Peruvian Government (Tax Authority and the Ministry of Mining and Energy) are among the entities that have filed their proof of claims against GSP.
- In 2018, 50 tax units are approximately USD 63,000.
- The mentioned exception is applicable only in case of the granting of a guarantee related to a particular asset (rights in rem duly registered before the Peruvian Public Registry such as a pledge or mortgage).
- For further detail and mechanisms for creditor's protection, see Renzo Agurto Isla, "Economic crisis, is it a good investment opportunity? The acquisition of assets or companies in pre-bankruptcy situations or subject to bankruptcy procedure" included in *lus Et Veritas* volume No. 54 (July 2017), pp. 116-118.
- In accordance with the 1993 Peruvian Constitution, the Insolvency Law establishes no difference between national and foreign creditors. However, the 1984 Peruvian Civil Code maintains particular preferences for domiciled creditors and credits registered in Peru. In our opinion, such differences are incompatible with the later 1993 Peruvian Constitution, so legal actions can be taken in order to avoid those provisions, if necessary.
- The maximum term for this type of liquidation is one (1) year, extendable for one (1) additional year.
- This issue is not regulated under the insolvency law. In the case of the bondholders, their participation is subject to the provisions in their contract(s) with the issuer. In the case of the lenders, they can directly participate in the proceeding without a trustee/agent.
- Mandatory only in a liquidation proceeding. In the event of a reorganization, creditor may opt for another payment structure.
- At the request of a party, the INDECOPI may suspend the effect of the plan during an appeal.
- Significant exclusions from automatic stay are: (i) debtor's obligations originating after the Bar Date, and (ii) debtor's assets that guarantee any third-party obligations originating before the Bar Date.
- In a preventive insolvency proceeding, management remains in place. In an ordinary proceeding, management remains in place unless the creditors' meeting opts otherwise.



▼ **Renzo Agurto Isla** is Counsel at Miranda & Amado Abogados, and co-heads the bankruptcy and corporate restructuring practice, with a focus on transactions in Peru.

Mr. Agurto Isla's practice focuses on bankruptcy and insolvency. He has participated in several complex restructuring and winding-up transactions representing debts of US\$1 billion. Recently, he participated as an expert witness on Peruvian insolvency laws during the appointment of a Chapter 11 trustee before the bankruptcy court of New York. He is currently leading the voluntary dissolution and liquidation of two companies in the financial sector regulated by the Superintendence of Banking and Finance, and recently led the voluntary dissolution and liquidation of a Peruvian bank. Additionally, he is advising several local companies as creditors within different insolvency proceedings before the INDECOPI (the Peruvian insolvency authority).

Mr. Agurto Isla is a member of the Lima Bar Association, Insol International and the American Bankruptcy Institute. From 2013 to 2014, Mr. Agurto Isla was a professor at ESAN University, where he taught corporate restructuring for the LLM program. He studied law at Universidad de Lima and received an LLM in business, corporate and maritime law from Erasmus University Rotterdam in the Netherlands.



▼ **Patricia Casaverde Rodriguez** is a senior associate at Miranda & Amado Abogados.

Ms. Casaverde Rodriguez's practice is focused on bankruptcy and insolvency. She has participated in several insolvency cases as a member of the chamber specialized in insolvency proceedings of the National Institute for the Defense of Competition and Protection of Intellectual Property (INDECOPI)'s Tribunal. She is currently participating in the voluntary dissolution and liquidation of two companies in the financial sector regulated by the Superintendence of Banking and Finance, and recently participated in the voluntary dissolution and liquidation of a Peruvian bank. Additionally, Ms. Casaverde Rodriguez is advising several local companies as creditors within different insolvency proceedings before the INDECOPI.

Ms. Casaverde Rodriguez studied law at Pontificia Universidad Católica del Perú and received an LL.M. from Northwestern University. She is a member of the Callao Bar Association.