Using Blacklisting Against Corrupt Companies

Query:

"What are the experiences with blacklisting? Is this a useful instrument? In which areas/sectors can this be used? What should a good blacklisting mechanism look like (duration of listing, indicator for listing etc)? Is blacklisting only good for listing companies or can it also be used elsewhere?"

Purpose:

"Fighting private to private and private to public corruption has proved to be difficult. The OECD Convention, the Global Compact and Voluntary Codes of Conduct seem too weak as instruments (see the Siemens case). Blacklisting seems to be the most workable instrument to hit the companies where it hurts most - at their profits. But this is just an impression and I would be interested in international experiences."

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Part 1: Characteristics of a "Blacklisting" or "Debarment" Mechanism

In this section we describe the characteristics of an effective "blacklisting" or debarment system. Debarment in the realm of public contracting is a process whereby, on the basis of pre-established grounds, a company or, indeed, an individual, is prevented from engaging in further contracts for a specified period of time. Our research indicates that debarment can be potentially used in any sector in which public contracting takes place. In Part 2 we will describe in greater detail particular debarment mechanisms.

Debarment may be preceded by a warning of future exclusion should the conduct persist, the conduct be repeated, or occur under aggravated circumstances. An investigation that could lead to debarment may be triggered by an existing judicial decision, or when there is strong evidence of unethical or unlawful professional or business behaviour. Many debarment systems today have adopted the latter practice as judicial decisions are often slow to obtain.

The key function of debarment in public contracting is prevention and deterrence. Since the instrument should be primarily preventive it should be designed to give the company an

incentive to step forward if they discover irregularities. Companies should also be encouraged to set up effective and monitored anti-corruption procedures in order to avoid being listed.

For companies debarment means a damaged reputation, lost business prospects and even bankruptcy. Debarment systems have been around for some time, both at the national and the international level. The US debarment system is among the oldest, and its grounds for debarment include anti-trust violations, tax evasion and false statements, in addition to bribery in procurement-related activities.

The World Bank has taken the lead internationally: its debarment system was made publicly available in 1998 (see Part 2). Since 2003, the European Commission's financial regulations have included a debarment system that is currently being developed (see Part 2 for further details about the EU system). Almost all development banks now have debarment systems of some kind and, at the national level, many countries have, or are seriously considering, blacklisting systems. (These countries include: Bangladesh, Brazil, China, the Czech Republic, France, Germany, India, Kenya, Nepal, Pakistan, the Philippines, Romania, Senegal, Singapore, South Africa, South Korea, Sweden, Tanzania, Turkey, Uganda, the United States and Zimbabwe).

Many of the current debarment systems have been criticised for being closed, poorly publicised or unfair, and for failing to include big companies with proven involvement in corrupt deals. See, for example, Steven Schooner, 'The Paper Tiger Stirs: Rethinking Suspension and Debarment' *Public Procurement Law Review*, (2004).

The Lesotho case, a very prominent case of international bribery, offers an example of a successful debarment procedure against a company. It involved bribery by the Canadian engineering giant Acres International of the Lesotho Highlands Development Authority (LHDA), which was in part overseeing the Lesotho Highlands Water Project that was developed by Lesotho and South Africa. The debarment of Acres International Ltd by the World Bank signalled an emboldening of institutions that wish to demonstrate intolerance of corruption. The decision to debar Acres also helped dispel the fear that debarment agencies might face reprisals, such as allegations of slander or misjudgement. For further details of this particular experience with debarment including an analysis of the pressures brought to bear on all the actors involved please see the following links. Here you will find analysis of the World Bank's decision to debar Acres International, provided by The Bretton Woods Project, a pressure group that works to scrutinise and influence the activities of the World Bank and the IMF: "Landmark decision: Canadian Company debarred" at http://www.brettonwoodsproject.org/art.shtml?x=42230 and for background please see "Acres Debarment: Litmus Test for bank on Corruption" at http://www.brettonwoodsproject.org/art.shtml?x=62691

The two main problems that Transparency International has encountered with blacklisting are: an unwillingness to debar on the basis of 'strong evidence' (without a court order); and resistance to giving the public access to blacklists.

In order to be effective and to stand up to scrutiny and possible legal challenges, certain steps need to be taken when designing and implementing a debarment system. Effective debarment systems must be fair and accountable, transparent, well publicised, timely and unbiased.

1. Fairness and accountability. Clear rules and procedures need to be established and made known to all the parties involved in a contracting process, ahead of time. The process needs to give firms and individuals an adequate opportunity to defend themselves.

2. Transparency. Sanctions and the rules regarding the process must be made public in order to minimise the risk of the debarment system being subjected to manipulation or pressure. The outcomes must also be publicised. Contracting authorities and export credit agencies need to be given access to detailed information from the debarment list so that they can carry out due diligence on potential contractors (for overseas tenders this might mean accessing the debarment system in the home country).

This process is especially complicated because owners of debarred companies may simply start up a new company operating under a new name. Up-to-date public debarment lists can help procurement officers and due diligence analysts keep track of such cases. Publicity also has an important impact on the legitimacy, credibility and accountability of debarment agencies, and facilitates monitoring by independent parties. The information made public in debarment lists needs to include the company or individual's name, the grounds for investigation, the name of the project, the country of origin of sanctioned firms or individuals, as well as the rules governing the process.

3. Functionality. Publicly available debarment lists facilitate electronic matching and other information-sharing features that organisations such as the World Bank's International Finance Corporation already have in place. Systems could be interconnected internationally, for example, among development banks, or between countries. Such networking may even reduce operating costs, and make systems more effective.

4. Timeliness. Debarment systems should be timely. The Lesotho case shows that delays in beginning the debarment process increase costs and erode credibility.

5. Proportionality. One of the key arguments is that debarment has to be proportionate; therefore, by way of example, a company like Shell would not be blacklisted in the EU because, for instance, one of it's subsidiaries in Nigeria paid a small bribe. For some companies, being barred from a particular market might mean bankruptcy, so in certain cases a debarment of five years could be too much. The system should allow for a sliding scale of penalties, and should provide entry and exit rules. If a company has shown that, after the offence, it implemented substantial changes, for example, by enforcing codes of conduct, or changing policies and practices, it should be possible to lift the debarment.

For more information see Juanita Olaya, "Blacklisting Corrupt Companies" in Transparency International's *Global Corruption Report* 2005
http://www.transparency.org/publications/gcr/download_gcr/download_gcr_2005#download

Part 2: Examples of Debarment Mechanisms

World Bank

The World Bank has a debarment system and, just recently, it has implemented a "Voluntary Disclosure Program" as a preventive measure to enable companies to stay corruption-free and avoid debarment. Both of these mechanisms are described below.

- *World Bank Debarment System*

The World Bank publicly lists blacklisted companies on its website. At the following link you will find a public list of all companies and individuals that are currently debarred:
http://web.worldbank.org/external/default/main?theSitePK=84266&querycontentMDK=64069700&contentMDK=64069844&menuPK=116730&pagePK=64148989&piPK=64148984

Firms that are found to have violated the fraud and corruption provisions of the World bank *Procurement Guidelines* or the World Bank *Consultants Guidelines* (clauses 1.14 and 1.22, respectively) are blacklisted. In order to determine whether firms have violated these provisions an administrative process is undertaken that enables the accused firms and individuals to respond to the allegations.

In the case of a debarred firm, ineligibility extends to any firm or individual which directly or indirectly controls the debarred firm or any firm which the debarred firm directly or indirectly controls. In the case of a debarred individual, ineligibility extends to any firm which the debarred individual directly or indirectly controls.

- *World Bank Voluntary Disclosure Programme*

The following information is taken from the World Bank website. See:
http://web.worldbank.org/WBSITE/EXTERNAL/EXTABOUTUS/ORGANIZATION/ORGUNITS/EXTDOII/EXTVOLDISPRO/0,,contentMDK:20996886~menuPK:2720524~pagePK:64168445~piPK:64168309~theSitePK:2720459,00.html

What is the VDP?
Under the VDP, participants commit to (1) not engage in misconduct in the future; (2) disclose to the Bank the results of an internal investigation into past fraudulent, corrupt, collusive, or coercive acts in Bank-financed or supported projects or contracts; and (3) implement a robust internal compliance program which is monitored by a Bank-approved compliance monitor. Participants pay the costs associated with almost every step of the VDP process.

In exchange for their full cooperation, VDP participants avoid debarment for disclosed past misconduct, their identities are kept confidential, and they may continue to compete for Bank-supported projects. Similar programs successfully promote legal compliance in the European Union, Brazil, Japan, Pakistan, the United States, and other countries.

How does the VDP operate?
All firms, other entities, and individuals performing under Bank-financed or supported projects or contracts are eligible to participate in the VDP unless they are Bank staff or under active investigation by the Bank. Participants enter the VDP by agreeing to a non-negotiable, standardized set of Terms and Conditions.

A VDP participant conducts an internal investigation of all its Bank-project-related contracts that were signed or in effect in the five years prior to its entry into the VDP. The participant reports the results of its investigation to the Bank, and the Bank verifies the completeness and accuracy of that investigation. The Bank then shares selected disclosures with member

countries, Bank management and staff, and other stakeholders through reports carefully redacted to keep the VDP participant's identity confidential.

A Bank-approved compliance monitor monitors a participant's internal compliance program for three years and reports annually to both the participant and the Bank. The Bank will debar, for a period of ten years, any participant that continues to engage in misconduct or otherwise materially violates the VDP Terms & Conditions.

European Union system of debarment

On 13 December 2006 the European Union Council of Ministers introduced a financial regulation which includes a revised debarment (or blacklisting) system for organisations, companies and other contractors found guilty of misusing EU funds. Under this system a database has been established which lists all organisations, companies or contractors which have misused EU funds. Access is currently restricted to the purchasing institutions that manage the budget. Authorities are not obliged to consult the database before awarding a contract but rather the regulation depends on a voluntary system. At the end of this document, in Appendix 1, we include an extract that we have prepared of the provisions in the 13 December Financial Regulation that are relevant to the EU blacklisting system. NB: the term debarment or blacklisting is not mentioned within the text, rather the text simply refers to a central database.

The EU debarment mechanism is now subject to an implementing process by the Commission and Member States until around April 2007. This implementing process may provide time in which to smooth out some of the weaknesses in the system. For instance, open access to the general public would be much more transparent and it is in the companies own interest as it does ensure fairness. The fact that organisations can continue to get access to other areas of the budget after being convicted of fraud is contradictory. It should be obligatory for authorities to consult the database before awarding a contract, rather than depending on a voluntary system as foreseen in the regulation.

TI has put together a series of recommendations for the EU debarment system which can be found at the below link. In sum, the recommendations are as follows:

TI recommends that the EU debarment system:

- Be implemented with the aim of curbing corruption by promoting trustworthiness among EU funds users, managers and providers, and promoting behaviour change.
- Be consistent in its application; this requires among others:
  a. The development of implementation guidelines,
  b. The centralization of the debarment/sanctioning function.
- Be guarded by concrete elements that provide the assurance of due process.
- Be transparent and, in particular, that the relevant mechanisms to actively make the relevant information available to the authorizing officers and the public be put in place.
- Be proportionate, fair, timely and accountable; this requires among other elements that:
  a. Due process must guide entry (listing) and exit (de-listing) procedures,
  b. Clear criteria must guide the implementation of discretionary debarment,
  c. Debarment must be automatic in cases of res judicata,
  d. Authorizing officers should be obliged to check entries into a consolidated debarment "register" before contracting,

e. Mechanisms to facilitate full and timely exchange of information on debarment should be set in place with Member States and international institutions,
f. Debarment should be applied with proportionality and fairness, and take account of mitigating circumstances.

http://www.transparency.org/content/download/5661/32802/file/TI_EU_Debarment_Recommendations_06-03-28.pdf

Many EU Member States also have their own debarment systems. We attach a document which outlines the procedures in the following countries: Austria, Cyprus, Czech Republic, Denmark, Estonia, France, Hungary, Latvia, Lithuania, Malta, Poland, Slovenia, Spain, Sweden and the United Kingdom.

Part 3: Further reading

U4 Special Page "Debarment as an anti-corruption means"
http://www.u4.no/themes/debarment/main.cfm
Here you will find details of a study carried out by Jeremy Pope, Alan Doig and Jon Moran on effectiveness of a formal debarment (or blacklisting) process as a means to challenge corruption openly, and in particular debarment as a means of reducing levels of corruption in public procurement processes.

The study demonstrates that debarment can be effective as one of a number of means to deter and - if detected - sanction those involved in corruption during the public procurement process in early stages of use. It must be clearly stated that while a number of multilateral and bilateral agencies are now beginning to use debarment as a sanction, many developed countries have yet begun to introduce similar sanctions as part of their export credit support to their companies operating transnationally. Evidence-based analysis of the impact of debarment is thus almost non-existent.

One aspect of this study - the analysis of the Lesotho Highland Water Supply project - suggests that debarment could be a potent deterrent. Indeed three case studies at state (New York), national (Singapore) and international (World Bank) levels, confirm that agencies do consider that debarment has a role in the range of means intended to protect the integrity of the public procurement process.

"Exporting Corruption: How Rich Country Export Credit Agencies Facilitate Corruption in the Global South" by The Corner House, published by Multinational Monitor May/June 2006. See http://www.thecornerhouse.org.uk/pdf/document/MMinterview.pdf
In this interview the question is posed by **Multinational Monitor**: "What are the best solutions, or key elements of solutions, to disentangle ECAs from corrupt practices? How important should be the role of debarment, and is debarment politically feasible?"

The Corner House replies: The most effective measure to tackle corporate bribery is refusing ECA support for a set period of time to companies convicted of corrupt business practices. The World Bank and some other international financial institutions already use debarment as an anti-corruption tool. All EU members states are now obliged to exclude from public procurement contracts companies that have been convicted by final judgment of corruption offenses.

The OECD has suggested debarring as an economic disincentive against corporate bribery. The ECAs of Belgium, Denmark, Greece, Hungary, Luxembourg and Switzerland say that it is their practice, though not a required practice, to deny official support where there has been a conviction for corruption.

Anti-corruption groups are also pushing for mandatory rules that would obligate ECAs to: require companies to disclose the names of their agents; introduce a ceiling on commission payments; withhold support where there are detailed and credible suspicions of bribery and where an official investigation has been opened; have in place rigorous anti-corruption due diligence procedures and audit procedures that will allow spot checks on customer documentation; inform national investigative authorities of suspicions or evidence of bribery as a matter of routine and required practice, and put in place appropriate whistleblower procedures to enable people both within the Export Credit Agency and outside it to raise concerns about corruption in projects supported by the ECA; and refuse cover to companies who have, or whose senior executives have, been convicted of corruption or bribery. Several ECAs have already adopted some of these procedures.

TI Global Corruption Report 2005:
http://www.transparency.org/publications/gcr/download_gcr/download_gcr_2005#download

TI Page on debarment
http://www.transparency.org/global_priorities/public_contracting/key_sectors/special_topics

Appendix 1

Extract from the EU Financial Regulation 13 December 2006 that refers to the EU system of debarment. This text is taken from a provisional edition of the text which is not yet widely distributed. The sections that refer to the blacklisting system are highlighted in bold text (and indeed the terms blacklisting or debarment themselves are not used)

(31) In order to enhance the effectiveness of procurement procedures, the database of candidates or tenderers in situations of exclusion should be common to the institutions, executive agencies and bodies referred to in Article 185.
[…]
(52a) Transitional provisions should be added. First, in Article 181(1), as regards the making available again of decommitted appropriations corresponding to commitments made during the 2000-2006 Structural Funds programming period, the case of force majeure should continue to be applied as provided in the Financial Regulation of 25 June 2002 until the closure of the assistance. This is in order to avoid disruption of the current system since force majeure is treated differently in the new Regulation governing the Structural Funds. **Second, in Article 181(2), to deal with the implementation of the provisions on the central database for exclusion from participation in procurement and grant procedures.** Finally, in Article 181(3) to deal with the outstanding Community commitments to be financially settled in order to close the assistance provided for in the Regulations governing the Structural Funds and the Cohesion Fund for the 2000-2006 programming period. For the appropriations concerning operational expenditure, the possibility for the Commission to make transfers from one title to another must be preserved, provided that the appropriations in question are for the same objective. Similarly, the Commission may continue to make transfers from one title to another when the appropriations in question relate to Community

initiatives or technical assistance and innovative measures, provided that they are transferred to measures of the same nature. This means for instance transferring appropriations relating to one Community initiative to another, in a different title.

[…]

Article 95

1. A central database shall be set up and operated by the Commission in compliance with Community rules on the protection of personal data. The database shall contain details of candidates and tenderers which are in one of the situations referred to in Articles 93, 94, 96(1)(b) and (2)(a). It shall be common to the institutions, executive agencies and the bodies referred to in Article 185.

2. The authorities of the Member States and third countries as well as the bodies, other than those referred to in paragraph 1, participating in the implementation of the budget in accordance with Articles 53 and 54, shall communicate to the competent authorising officer information on candidates and tenderers which are in one of the situations referred to in Article 93(1)(e), where the conduct of the operator concerned was detrimental to the Communities' financial interests. The authorising officer shall receive this information and request the accounting officer to enter it into the database.

The authorities and bodies mentioned in the first subparagraph shall have access to the information contained in the database and may take it into account, as appropriate and on their own responsibility, for the award of contracts associated with the implementation of the budget.

3. Transparent and coherent criteria to ensure proportionate application of the exclusion criteria shall be laid down in the implementing rules. The Commission shall define standardised procedures and technical specifications for the operation of the database.