

COUNCIL ON ETHICS

THE GOVERNMENT PENSION FUND GLOBAL

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To Norges Bank

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**Recommendation to put a company in the Government Pension Fund
Global under observation:**

Petroleo Brasileiro SA

Summary

The Council on Ethics recommends putting Petroleo Brasileiro SA (Petrobras) under observation due to the risk of gross corruption.¹ Senior executives of the company and its most important suppliers have apparently for a decade organised a system of paying large bribes to top politicians, political parties and civil servants. Several of the company's senior executives also received large kickbacks. Three former employees have already been convicted of such offences. The case is still being investigated in Brazil. The US authorities have also started to investigate allegations of corruption. The Council does not believe that the company has sufficiently proved it is effectively implementing its internal anti-corruption procedures. The fact that the Council nonetheless advises putting Petrobras under observation and not excluding it is because the company's anti-corruption procedures are recently established. In addition, the extensive investigation in Brazil, the negative attention that the company has received both in Brazil and internationally and Brazil's new anti-corruption legislation all reduce the risk of corruption reoccurring.

In brief about Petrobras

Petrobras is the largest listed company in Latin America and engages in activities relating to the production and refining of oil and gas. Petrobras was founded in 1953 as a state-owned oil company that had a monopoly on all oil activity in Brazil. In 1997, new legislation allowed competition in all parts of Brazil's oil and gas industry.

What the Council has considered

The Council has considered whether there is an unacceptable risk of Petrobras being responsible for gross corruption according to the section 3 subsection 3 letter d) of the Guidelines for Observation and Exclusion of Companies from the Government Pension Fund Global.

The Council has assessed whether there is an unacceptable risk of Petrobras having committed acts of gross corruption and of Petrobras being involved in corresponding acts in the future.

The Council's investigations and assessment

The Council has commissioned two studies by consultants of the allegations of corruption made by the press in this case. The Council was in contact with Petrobras several times in 2014 and 2015. The company has provided information on the case and also commented on a draft recommendation.

Petrobras is linked to Brazil's most extensive corruption case ever. Senior executives of the company and its most important suppliers are accused of organising a system of paying large bribes to top politicians, political parties and civil servants over a period of 10 years. The senior executives also received kickbacks. Based on the extensive investigation in Brazil, which has so far resulted in a number of charges, indictments and legal rulings that convict former senior executives of paying and receiving bribes as part of the operations, it appears that Petrobras may be responsible for acts that must be considered as gross corruption. Based on the available information, it also appears that the corruption has existed in the company for many years. The company's largest suppliers had for a long time participated in a cartel whose members were awarded specific contracts pursuant to an agreement. These contracts were

¹ The company has Issuer ID 136114.

over-invoiced and around 3 per cent of the contract sum was paid as bribes to civil servants and as kickbacks to Petrobras employees. The suppliers paid the bribes either directly to the recipient or via agents. Through these activities, both internal and external tender rules, among other things, were deliberately circumvented. The total amount paid as bribes probably equals several billion US dollars.

The Petrobras investigation is ongoing. According to Brazil's prosecuting authority, 35 indictments have been preferred against 173 individuals in the case.

In its communication with the Council and in press releases, Petrobras has alleged it is a victim of criminal offences committed by individuals, and refers to the fact that it has the legal position of an aggrieved party in the corruption case in Brazil. Among other things, funds that former employees have received as kickbacks have been returned to the company. However, witness statements in several of the court cases that have been held allege that corruption was an integral part of Petrobras' tender processes. It also appears that the senior management's taking of bribes was a key part of the corruption that took place in Petrobras for many years.

Based on that which is now known about the case in Brazil, the Council believes that in any case former internal systems must have failed and that defects in the internal controls probably allowed the extensive corruption to take place for so many years. The Council finds that the company had not defined and organised its anti-corruption procedures properly until 2013. If such procedures existed, it is clear that they did not effectively reveal and prevent extensive corruption, thus allowing corruption to flourish freely. The scope of this indicates that the rest of the management should have known what was going on.

Petrobras operates in many countries where there is a high risk of corruption. Both the oil and gas industry and building and construction industry, which also affect a large part of the company's operations, expose the company to considerable risk. In the Council's opinion, this places a special requirement on the company to have in place robust systems and implement anti-corruption measures. The number of corruption allegations against current and former company employees strengthens this requirement further. It is the company that bears the burden of proving that it works in a targeted and efficient fashion to prevent corruption.

The Council has placed emphasis on the fact that a relatively new anti-corruption programme was launched in 2013. Several key parts were not introduced until 2014. The company provides information on the main elements of this system, which on the whole is the same information as that available on the company's website. The system apparently contains the elements that such systems are expected to have. However, it seems clear that the implementation of this system is in a start-up phase and there is little publicly available information on how the system is implemented in practice throughout the organisation. The Council has the impression that the anti-corruption programme has been introduced first in Brazil but has only to a limited extent been implemented outside the country.

In its assessment, the Council places emphasis on how the company communicates the importance of anti-corruption work both internally and externally. The company has made radical changes to its board and group management after extensive corruption in the company was revealed in 2014. This may in itself signal a new direction. At the same time, the company underlines both in public and to the Council that it is a victim of some individual employees' actions. In light of the extremely comprehensive acts of corruption involving leading Petrobras employees, this gives the impression that the company is denying any liability.

The Council assumes that the high level of attention that the case has received both in Brazil and internationally will probably force the company to take additional steps in the right direction. Reference is made to the fact that Brazilian authorities passed new legislation in 2013 and 2015 which stipulates clearer requirements as to the ways in which companies handle and prevent corruption. The Petrobras case is also a clear signal to the Brazilian people and the rest of the world that there is both an ability and willingness to investigate, prosecute and convict people of acts of corruption in Brazil. In this case, it appears that no one will be left alone – neither senior executives, top politicians nor civil servants. Based on the above, the Council believes that Petrobras has a responsibility for the gross corruption that has taken place in connection with its activities. During the past few years, the company has taken steps to establish an anti-corruption system that reflects international norms and best practice. However, the Council doubts whether these measures will be sufficiently effective and therefore recommends putting Petrobras under observation.

The investigations have not been concluded. The Council will carefully monitor developments in the case over the coming year and reassess the matter in 2016. Should further cases of gross corruption be revealed in Petrobras' operations and the company cannot satisfy that the anti-corruption programme is being complied with and effectively improved, the condition for exclusion may be met.

Contents

1	Introduction	2
1.1	What the Council has considered	2
1.2	Sources	3
2	The Council on Ethics' findings	3
2.1	Corruption allegations in Brazil involving Petrobras	3
2.2	Other corruption allegations involving Petrobras	7
3	Standards for corporate compliance and anti-corruption processes and controls	7
4	Information from the company	9
5	The Council on Ethics' assessment	11
6	Recommendation	13

1 Introduction

Petrobras is the largest listed company in Latin America and is involved in oil and gas production and refining. It was founded in 1953 as a state-owned company with the aim of conducting petroleum activities on behalf of the Brazilian State. Until 1997, Petrobras had a monopoly on all petroleum activities in Brazil. In 1997, legislation changed this situation and opened up all parts of Brazil's oil and gas industry to competition.

Petrobras has significant assets in oil and gas fields outside Brazil too, including in much of Latin America and in Mexico, the USA, Nigeria, Angola, Tanzania and Asia.²

The company is headquartered in Rio de Janeiro and listed on the Sao Paulo, New York, Madrid and Buenos Aires stock exchanges. At the end of 2014, Petrobras had more than 80,000 employees and 25 subsidiaries, of which two are registered in the Netherlands, one in Austria, one in the Cayman Islands and the remainder in Brazil.³

As at 31 December 2014, the Norwegian Government Pension Fund Global held shares in Petrobras worth approximately NOK 2.2 billion, equivalent to an equity holding of 0.61 per cent.⁴

1.1 What the Council has considered

The corruption allegations embroiling former Petrobras employees concern bribes paid to public officials in Brazil through suppliers, the receipt of kickbacks by several of the company's top management and corruption in connection with the company's acquisition of refineries in locations including Brazil, the USA and Argentina. In accordance with the Guidelines for Observation and Exclusion of Companies from the Norwegian Government Pension Fund Global, section 3, subsection 1, letter d),⁵ the Council has considered whether there is an unacceptable risk that Petrobras contributes to or is itself responsible for gross corruption.

The Council has previously utilised the following definition in its assessments regarding the term "gross corruption":⁶

"Gross corruption" exists if a company through its representatives

² The company's website <http://www.petrobras.com/en/about-us/global-presence/> and Form 20F, 2013 of the American SEC, <http://www.investidorpetrobras.com.br/en/annual-reports/form-20f>.

³ The company's 2014 report to the American Securities and Exchange Commission, *SEC-filings 20-F*, dated 15 May 2015, http://www.sec.gov/Archives/edgar/data/1119639/000129281415001242/pbraform20f_2014.htm#_Toc418234521.

⁴ The Brazilian State is the principal shareholder and held 50.26 per cent of the voting shares at 31 December 2014. In addition, the Brazilian Development Bank (*Banco Nacional de Desenvolvimento Econômico e Social*, 'BNDES') owns 9.87 per cent of the voting shares.

⁵ Section 3, subsection 1 of the Guidelines reads: "Companies may be put under observation or be excluded if there is an unacceptable risk that the company contributes to or is responsible for: d) gross corruption ..." For the Guidelines for Observation and Exclusion of Companies from the Norwegian Government Pension Fund Global, see <http://etikkradet.no/en/guidelines/>.

⁶ The Council on Ethics' recommendation to exclude the French company Alstom SA, 1 October 2010, http://www.regjeringen.no/upload/FIN/etikk/2011/Alstom_norsk.pdf.

- a) *Gives or offers an advantage – or attempts to do so – so as to unduly influence:*
 - i) *a public servant in the execution of public duties or in decisions which may bring the company an advantage, or*
 - ii) *a person in the private sector who takes decisions or has influence on decisions which may bring the company an advantage,*

b) *demands or receives bribes,*

and

- c) *the corrupt acts mentioned in letters a and b are carried out in a systematic or comprehensive manner.*

2) In its assessment, the Council also places emphasis on whether the company has implemented effective anti-corruption procedures that are organised in a way that enables it to prevent, detect and respond to corruption.

In light of this, the Council has considered whether there is an unacceptable risk that Petrobras is involved in gross corruption and may be involved in similar acts in the future.

In assessing whether this case involves gross corruption, the Council has particularly emphasised the provisional results of the wide-ranging corruption investigation in Brazil. This includes judicial decisions linked to the case. As for the assessment of the risk that Petrobras may again be involved in similar acts, the Council has emphasised the company's reactions to the corruption allegations, the countries and industries that the company operates in, and the steps that the company has taken to prevent, detect and respond to corruption.

1.2 Sources

The information obtained relating to corruption allegations stems from the international press and judicial decisions involving former Petrobras top executives, among others, which were handed down in April and July 2015 by the Federal Court of Curitiba, Brazil. The Council has also commissioned consultants to review the information that has been published regarding corruption allegations in the press.

The assessment of the company's compliance systems is based on information available on the Petrobras website and written and oral communications between the Council and the company. The Council has additionally garnered information about how Brazilian enterprises are expected to implement and comply with national anti-corruption legislation.

2 The Council on Ethics' findings

2.1 Corruption allegations in Brazil involving Petrobras

In 2013, the Federal Police in Brazil became suspicious of payments from an agent, [REDACTED] to [REDACTED] Petrobras' Downstream Division from 2004 to 2012. The payments were discovered in connection with investigations into an extensive money-laundering operation connected to one of the company's projects.

The investigation into █████ and █████ initially concerned the Abreu et Lima refinery in northeast Brazil. Petrobras originally budgeted total expenditures of USD 2.5 billion, but the final sum at completion had risen to USD 20 billion. According to Credit Suisse, this is one of the most expensive refineries ever constructed. The investigation revealed that large parts of the company's funds, earmarked for the refinery, were transmitted between █████ and █████ before being "laundered" through a car-wash company and sent to a hidden account abroad.⁷ █████ and █████ have since admitted, both in police interviews and in court, that large sums ear-marked for the company's projects were paid in bribes to public servants and as kickbacks to Petrobras top management.

During the investigation in 2014, █████ and █████ decided to cooperate with the public prosecutor to earn shorter sentences. This initiated the disclosure of the most extensive corruption case ever seen in Brazil. █████ and █████ testified that a series of individuals and companies had participated in a cartel and, based on an agreement, had been awarded certain contracts. The contracts were overcharged and about 3 per cent of the contract value was paid in bribes to public servants and in kickbacks to Petrobras employees.⁸ The suppliers distributed the bribes either directly to the recipient or via agents. █████ role was to make sure that everyone received their share. Most of the bribes were apparently paid to politicians and political parties, including the governing Workers Party (*Partido dos Trabalhadores*, PT).⁹

According to a legally binding judgement against █████ in 2015, decisions on the awarding of contracts and the determination of the prices of the contracts and size of the bribes took place at physical meetings between top Petrobras executives, the senior management of suppliers and politicians.¹⁰ These activities were carried out in several Petrobras divisions.¹¹

In court, █████ testified that the cartel operations must also have existed even before he took up his position in the company in 2004.¹² █████, a former █████, has admitted that he received kickbacks from suppliers who wanted to secure contracts with Petrobras way back in the 1990s.¹³ Both █████ and █████ have also explained that the Petrobras management knew what was going on, including that large sums were paid to public servants right up until 2012. █████ testified, in part, that he never had the authority to award contract awards by himself, but that Petrobras had extensive procedures for the tender processes, accreditation of contacts and payments. He testified that the contract manager,

⁷ Financial Times, 10 August 2014, <http://www.ft.com/intl/cms/s/0/6d00da0c-1c7c-11e4-98d8-00144feabdc0.html?siteedition=intl#axzz3IfH1NmGQ>. Because the money was laundered through the car-wash company, the investigation came to be known as *Operation Car Wash*, or *Lava Jato* in Portuguese.

⁸ This first became known in the press, i.a. the Financial Times, 10 August 2014, <http://www.ft.com/cms/s/0/6d00da0c-1c7c-11e4-98d8-00144feabdc0.html#axzz3IfH1NmGQ>. █████ here refers to the agreement as a "3 percent political adjustment". This was repeated in court testimonies in two subsequent criminal trials against █████, amongst others, including the judgements of 22 April 2015 and 20 July 2015, both pronounced by the Federal Court of Curitiba.

⁹ The court decisions of 22 April 2015 and 20 July 2015, both pronounced by the Federal Court of Curitiba.

¹⁰ Judgement of 20 July 2015 in the Federal Court of Curitiba, http://www.prpr.mpf.mp.br/pdfs/2015-1/lava-jato-1/sentenca_camargo%20e%20correa%20e%20utc.pdf, section 282.

¹¹ Judgement of 22 April 2015, pronounced by the Federal Court of Curitiba, sections 295-298. The divisions involved are the Downstream Division █████, the Services Division █████, and the International Division █████. █████ and █████ have now all been convicted in Brazil of corruption and other financial irregularities in connection with the Petrobras case.

¹² Judgement of 20 July 2015 pronounced by the Federal Court of Curitiba.

¹³ The Globe and Mail, 13 March 2015, <http://www.theglobeandmail.com/news/world/brazils-petrobras-scandal-widens-to-include-57-politicians/article23462484/>.

division directors and legal department were involved before a contract was finally approved by the board of directors and awarded to a given supplier.¹⁴

As certain of the public officials named by [REDACTED] and [REDACTED] as recipients of the bribes are under special jurisdiction and subject to the Supreme Court of Brazil's purview, the court would not permit their names to be released in the judicial questioning.¹⁵ However, it is known that the Supreme Court has initiated investigations into more than 50 top politicians and civil servants in connection with the Petrobras case, including a former president, two former chiefs of staff, two governors, one former minister and 34 members of Congress representing five political parties, almost all of whom are members of the present coalition government. Some of these individuals have allegedly already been indicted.¹⁶

The investigation into the case is ongoing. So far, 11 former top executives of Petrobras have been indicted in the case. In addition to [REDACTED] former [REDACTED], [REDACTED], has been convicted of corruption and other financial irregularities connected with the case.¹⁷ [REDACTED], former [REDACTED], and [REDACTED], were arrested in March this year, charged with corruption and other financial irregularities. The public prosecutor stated that he believed the authorities had evidence that [REDACTED] had requested "donations" from the company's suppliers, whilst [REDACTED] had taken part in meetings with [REDACTED] and [REDACTED], to discuss bribes which could be disbursed through electoral campaign funds. The same day that [REDACTED] and [REDACTED] were arrested, [REDACTED] was charged with corruption in connection with the case. He had already admitted to receiving USD 97 million in kickbacks in connection with contracts awarded by Petrobras, and has agreed to refund the entire sum.¹⁸ The most recent arrest in the case that the Council is aware of was that of [REDACTED] in July 2015. [REDACTED] replaced [REDACTED] in 2008 as [REDACTED]. He is now charged with corruption.¹⁹ In addition, three former [REDACTED] and three individuals holding other management positions in the company are allegedly also indicted in the case.²⁰

¹⁴ This is derived from the judgement against [REDACTED] and [REDACTED] and others as pronounced on 20 July 2015 by the Federal Court of Curitiba, http://www.prpr.mpf.mp.br/pdfs/2015-1/lava-jato-1/sentenca_camargo%20e%20correa%20e%20utic.pdf, section 282. [REDACTED] and [REDACTED] were in April 2015 convicted in connection with the Petrobras case, though this was for money laundering, see the judgement of 22 April 2015, pronounced by the Federal Court of Curitiba.

¹⁵ Judgement of 22 April 2015, pronounced by the Federal Court of Curitiba, section 60.

¹⁶ See The Guardian, 7 March 2015, <http://www.theguardian.com/world/2015/mar/07/brazilian-court-approves-investigation-into-politicians-in-petrobras-scandal>, and <http://www.theglobeandmail.com/news/world/brazils-petrobras-scandal-widens-to-include-57-politicians/article23462484/>.

¹⁷ The judgement against [REDACTED] was pronounced in the middle of August 2015. [REDACTED] was sentenced to more than 12 years and three months' imprisonment for paying bribes of USD 5 million to the [REDACTED] in Congress.

¹⁸ The Wall Street Journal, 16 March 2015, <http://www.wsj.com/articles/former-petrobras-executive-arrested-again-brazil-police-1426513758>. The article also reports that public authorities in Monaco have frozen USD 23.8 million belonging to [REDACTED] on suspicion that the money constitutes bribes received in connection with the case. [REDACTED] has stated, in part, that the Workers Party received approx. USD 200 million in bribes relating to contracts with Petrobras suppliers, see CNBC, 17 March 2015, <http://www.cnbc.com/2015/03/17/cial-charged-in-petrobras-bribery-case.html>.

¹⁹ The Wall Street Journal, 2 July 2015, <http://www.wsj.com/articles/brazil-federal-police-arrest-another-former-petrobras-executive-1435838298>.

²⁰ These are [REDACTED]
[REDACTED] O Globo, 19

Furthermore, three former chief executives of Camargo Correa, among Brazil's largest building and construction companies and one of Petrobras' key suppliers, were convicted of corruption and other financial offences in connection with the case.²¹ They were found guilty of overcharging Petrobras and paying bribes to public officials and Petrobras' top management. In court, it was acknowledged that Camargo had paid USD 15.6 million in bribes in connection with two contracts alone. Camargo's representatives explained in court that the cartel activities and corruption were considered "the rules of the game" and that they were a prerequisite for landing a contract with Petrobras. They also explained that they believed the bribes they paid to politicians would bring an advantage to Camargo in connection with other public-sector bidding processes.²²

In another instance, [REDACTED] was recently arrested.²³ He is the [REDACTED] Odebrecht SA, the largest building and construction company in Brazil and perhaps Petrobras' largest supplier. Subsequently, the Swiss police and prosecution service have also opened an investigation into [REDACTED] and additionally frozen some USD 400 million in assets which are believed to stem directly from the Petrobras case.²⁴

According to the public prosecution service in Brazil, 173 individuals have to date been charged with corruption and other financial crimes in connection with the case.²⁵ Additionally, multiple international companies that were suppliers to Petrobras are under investigation in connection with the case.²⁶ Petrobras itself has estimated its losses due to corruption at USD 2 billion. The public prosecution service in Brazil estimates that the actual losses are much higher.²⁷

The case is being investigated in Brazil by the Federal Police and Prosecution Service (*Ministério Público Federal*), by the Auditor General (*Controladoria-Geral da União*) and by the Federal Accounts Tribunal. In addition, Petrobras is according to several press articles being investigated for corruption by the US Department of Justice and Securities and Exchange Commission. Certain shareholders have also sued Petrobras in a New York court,

October 2015, <http://oglobo.globo.com/brasil/relatorio-da-cpi-da-petrobras-indicia-pessoas-sem-nome-17825544>.

²¹ They are [REDACTED], former [REDACTED] of Camargo Correa, and [REDACTED], former [REDACTED] of Camargo Correa.

²² Judgement of 20 July 2015 by the Federal Court of Curitiba, http://www.prpr.mpf.mp.br/pdfs/2015-1/lava-jato-1/sentenca_camargo%20e%20correa%20e%20ut.pdf. The judgement is mentioned in i.a. Folha, 21 July 2015, <http://www1.folha.uol.com.br/internacional/en/brazil/2015/07/1658368-petrobras-scandal-judge-condemns-former-executives-of-construction-company-camargo-correa-to-prison.shtml>.

²³ Reuters, 24 June 2015, <http://www.reuters.com/article/2015/06/24/us-brazil-petrobras-scandal-idUSKBN0P424320150624>

²⁴ Reuters, 24 June 2015, <http://www.reuters.com/article/2015/06/24/us-brazil-petrobras-scandal-idUSKBN0P424320150624>, and The Wall Street Journal, 22 July 2015, <http://www.wsj.com/articles/swiss-authorities-open-investigation-into-brazils-odebrecht-1437605540>. It follows from the WSJ article that Swiss investigators have uncovered over 300 accounts in more than 30 Swiss banks where illegal funds in connection with the Petrobras case were held.

²⁵ This is according to the website of the Public Prosecution in Brazil (MPF), <http://lavajato.mpf.mp.br/atuacao-na-1a-instancia/resultados/a-lava-jato-em-numeros>.

²⁶ Financial Times, 15 February 2015, <http://www.ft.com/intl/cms/s/0/96152e80-b3ca-11e4-a6c1-00144feab7de.html>.

²⁷ Financial Times, 2 July 2015, <http://www.ft.com/intl/cms/s/0/3c937964-20d7-11e5-aa5a-398b2169cf79.html#axzz3kUSYdgpF>.

demanding compensation for financial loss. Petrobras filed for dismissal of the case, arguing that the company is the victim. The company's plea was dismissed by a judge in July 2015.²⁸

2.2 Other corruption allegations involving Petrobras

In addition to the above-mentioned corruption allegations involving Petrobras, allegations of overcharging and illegal payments in connection with several of the company's overseas projects have been lodged. In a statement by the Auditor General of Brazil, it is noted that many of the company's overseas projects are under investigation.²⁹ According to a press article, a Brazilian senator is alleged to have received USD 1 million in kickbacks relating to the acquisition of a US refinery.³⁰ The allegations which are known regarding the company's overseas business are not as well documented as the corruption allegations referred to by the Council above. The Council has not given substantial weight to the allegations regarding overseas business in this recommendation and they will therefore not be described in further detail.^{31 32}

3 Standards for corporate compliance and anti-corruption processes and controls

Based on international standards for corporate compliance and anti-corruption, certain general principles can be derived regarding the actions that a company should take in order to establish and implement an effective anti-corruption programme. The efficient implementation of anti-corruption procedures is relevant for an assessment of the degree to which a company is capable of preventing any involvement in corruption.

Guidelines for the adoption and integration of internal anti-corruption efforts may be found in the UN's anti-corruption portal TRACK (*Tools and Resources for Anti-Corruption Knowledge*) and Global Compact: *A guide for anti-corruption risk-assessment* (2013) and the OECD's *Good Practice Guidance on Internal Controls, Ethics and Compliance* (2010). Transparency International (TI) has in its *Business Principles for Countering Bribery* compiled a list of many general recommendations for an effective compliance system.

The key requirements in international standards for corporate compliance and anti-corruption systems relevant to this case are that the company conducts a comprehensive assessment of

²⁸ See i.a. Bloomberg, 10 July 2015, <http://www.bloomberg.com/news/articles/2015-07-10/petrobras-judge-allows-lawsuit-while-dismissing-some-claims>. According to this report the case will be heard in a New York court in February 2016.

²⁹ Bloomberg, 21 October 2014, referring to the Court's decision, <http://www.bloomberg.com/news/articles/2014-10-21/brazil-fixated-as-human-bomb-revelations-rock-elections>.

³⁰ Houston Chronicle, 9 November 2015, *Scandal in Brazil snares refinery*, <http://www.pressreader.com/usa/houston-chronicle/20151109/281505045101952/TextView>.

³¹ The allegations concerning kick-backs in relation to the refinery in the US are amongst others mentioned in an article published in Washington Times, 21 March 2014, <http://www.washingtontimes.com/news/2014/mar/21/scandal-involving-refinery-hits-brazils-petrobras/#ixzz3IkJYe000> and in Bloomberg, 18 June 2015, <http://www.bloomberg.com/news/articles/2014-06-18/brazil-energy-giant-buys-1-24-billion-of-pain-in-texas>.

³² The corruption allegations in Argentina are amongst others mentioned in a Bloomberg article, 21 October 2014, <http://www.bloomberg.com/news/articles/2014-10-21/brazil-fixated-as-human-bomb-revelations-rock-elections>.

corruption risks in its business operations, that the company has zero tolerance for corruption, that all employees are equipped with tools to avoid becoming involved in corruption, and that relevant processes and procedures are continuously developed and improved.

A thorough survey and assessment of the corruption risk in a company are a prerequisite for establishing and implementing robust anti-corruption systems. Key risk factors that need consideration are the size of the company, local and regional factors, the sectors in which the company operates and prior experience. A minimum requirement is that the company has sound preventive procedures in the fields where it is most exposed to risk. In large corporations, the risk survey and assessment of measures should be repeated regularly, and especially exposed parts of the business should be monitored continuously. One key part of the risk survey also involves a review of the company's internal processes and procedures and training of employees, as well as an assessment of third parties (*compliance due diligence*). It is also important that the company has a unified procedure for reporting breaches of its guidelines, and the sanctions against persons who break the rules must be visible.

However, the most important issues are that anti-corruption processes and procedures are integrated into all aspects of the company's operations and culture, are organised adequately and are monitored, refined and constantly upgraded and made more efficient. The implementation of anti-corruption processes and procedures should be constantly improved based on among other things internal experience and external factors such as new legislation and best practice standards.³³

Petrobras is listed in Brazil and also, among other locations, in the USA.

Corporations are not subject to corporate criminal responsibility in Brazil except in cases of breaches of environmental law. A range of measures have, however, been implemented to create better transparency, Brazil has ratified a number of international anti-corruption

³³ The UN anti-corruption portal TRACK (*Tools and Resources for Anti-Corruption Knowledge*) is available at <http://www.track.unodc.org/Pages/home.aspx>, the Global Compact: *A guide for anti-corruption risk-assessment* (2013) is available at <https://www.unglobalcompact.org/resources/411>, and the OECD's *Good Practice Guidance on Internal Controls, Ethics and Compliance* (2010) is available at <http://www.oecd.org/investment/anti-bribery/anti-briberyconvention/44884389.pdf>. Transparency International's recommendations were launched in 2003, first revised in 2009 and most recently revised in 2013. The recommendations are available at http://www.transparency.org/whatwedo/publication/business_principles_for_countering_bribery. Furthermore, general anti-corruption principles are given in *The OECD Guidelines for Multinational Enterprises*, <http://www.oecd.org/daf/inv/mne/48004323.pdf>. The UK Bribery Act and Foreign Corrupt Practices Act (FCPA) have also been normative for international standards with regard to corporate anti-corruption efforts. In 2011, the UK Ministry of Justice published guidance on how companies should act to avoid criminal liability under the UK Bribery Act. The guidance is available at <http://www.justice.gov.uk/downloads/legislation/bribery-act-2010-guidance.pdf>. In 2012, the US Department of Justice (DoJ) and US Securities and Exchange Commission (SEC) published a guide to how companies should act to avoid criminal liability under the FCPA, called *A Resource Guide to the U.S. Foreign Corrupt Practices Act*, available at <http://www.justice.gov/criminal/fraud/fcpa/guide.pdf>. This guide also refers to other relevant guidelines, e.g. *Business Ethics: A Manual for Managing a Responsible Business Enterprise in Emerging Market Economies*, published by the Department of Commerce, International Trade Administration, available at http://ita.doc.gov/goodgovernance/business_ethics/manual.asp. Other relevant sources of international anti-corruption standards are The United Nations Global Compact (*The Ten Principles*), the Asia-Pacific Economic Council (*Anti-Corruption Code of Conduct for Business*), the International Chamber of Commerce (*ICC Rules on Combating Corruption*), the World Bank (*Integrity Compliance Guidelines*), and The World Economic Forum (*Partnering Against Corruption-Principles for Countering Bribery*).

conventions³⁴ and new national legislation was adopted to combat corruption in 2013. According to this, companies are, for the first time, held civilly and administratively accountable for any corruption-related conduct by their representatives. The new law, the *Clean Company Act*, entered into force in 2014.³⁵

In a March 2015 amendment to the *Clean Company Act*, and other international legislators in this field, the Brazilian authorities set out specific requirements for corporate anti-corruption policies and procedures. In assessing a relevant civil or administrative reaction, the authorities may among other things give weight to whether a company has an independent compliance organisation with responsibility for anti-corruption, a genuine "*tone from the top*", written guidelines and procedures which are binding for executives and employees, effective and targeted training and communication, periodic risk assessments and audits, compliance due diligence of third parties, specific compliance policies and procedures for public procurements and M&A processes, internal controls and procedures for reporting and an adequate response to violations, as well as to how the compliance programme is continuously monitored and improved.³⁶ This Act by and large converges with the requirements as to the prevention of and response to corruption set out in the US Foreign Corrupt Practices Act (FCPA) and UK Bribery Act.

As a result of its activities, Petrobras is also directly subject to the US FCPA and UK Bribery Act, under which a corporation may be held criminally liable for corruption. The US Department of Justice and UK Ministry of Justice have issued clear recommendations regarding the preventive measures that a company should implement in order not to be held liable or in order to receive reduced sentences under the FCPA. The US standards are further defined by US sanctioning procedures and in deferred prosecution agreements between judicial authorities and a number of companies over the past 10 years.

4 Information from the company

Between October 2014 and December 2015, the Council on Ethics engaged in a dialogue with Petrobras in writing and via telephone conferences. Petrobras was asked to comment on the corruption allegations, to explain in detail its corporate compliance management systems and anti-corruption processes and controls and to describe how these are implemented in its overall business in order to effectively prevent, detect and respond to corruption. Petrobras has also commented on a draft recommendation to put it under observation.

In its dialogue with the Council, Petrobras states that it is a victim. It refers to its position as a victim in the corruption investigations in Brazil and in criminal trials against former top executives. It has therefore requested and also been given compensation for economic losses. The company furthermore refers to the fact that it is several former employees and company suppliers, and not the company itself, that are subject to corruption investigations in Brazil.

³⁴ These include, for example, the *OECD Anti-Bribery Convention* (implemented by Decreto No. 3.678/2000) and the *United Nations Convention Against Corruption* (implemented by Decreto No. 5.687/2006).

³⁵ The Brazilian Anti-corruption Act is included in *Lei No. 12.846/13*. Important anti-corruption provisions have also been incorporated in the Penal Code (Código Penal), including active and passive corruption and bribery in international business, cf. article 319.

³⁶ *Decree No. 8.420*, 18 March 2015, English version available at i.a. <http://www.merrillbrink.com/translation-of-Brazil-decree-Clean-Company-Act-04062015.htm>.

Petrobras has launched an internal investigation into the corruption allegations in Brazil. Two firms of attorneys have been assigned to this task. An independent committee, the *Special Committee*, was appointed as a reporting channel between the attorneys and the company's board of directors. The committee has a mandate to approve the method applied by the independent investigators, to receive and analyse their reports, and to analyse, approve and facilitate the recommendations issued by the attorneys. This committee has recently issued a number of recommendations to improve the current compliance and anti-corruption policies and procedures and several of these have already been implemented.

Further, the company's board initiated a new anti-corruption programme on 4 July 2013. The company had certain anti-corruption policies and procedures in place prior to 2013 too. According to the company, there was zero tolerance for corruption; as far back as in 1998, the board approved a Code of Ethics which also applied to its subsidiaries; and channels existed for reporting acts of corruption and other alleged misconduct in company operations.

Several of the existing anti-corruption policies and procedures were established after 2013. The *Code of Conduct* sets out specific guidelines applying to board members, management and all employees.³⁷ In addition, a new management position was created in 2015, the *Chief Governance, Risk and Compliance Officer*. He has the overall responsibility for preventing corruption in the company, and three subdivisions report directly to him: *Governance*, *Corporate Risk Management* and *Compliance*. The Compliance Department is responsible for managing several compliance issues, including corruption risk, and has more than 200 employees.

It has been explained that, before the new anti-corruption procedures were implemented in 2014, the overall risk assessment consisted of a review of relevant legislation, a benchmarking against corporate anti-corruption policies and procedures in the industry, and an assessment of the risk in the sectors and countries in which Petrobras operates.

The Council has been further informed that Petrobras is developing programmes which are intended to ensure that all employees receive anti-corruption training. In 2016, all employees will receive training through a web-based training programme. A large number of among others executives and managers in Brazil received classroom training in 2015. Petrobras will further develop customized training programmes for employees in high-risk positions, such as procurement and bidding areas, as well as HR.

Further, the company has outsourced the work of receiving and logging reports of misconduct to an external contractor. In addition, there are internal reporting mechanisms, such as the possibility to report to management. The Council has not received any information about the number of alleged bribery and corruption cases reported so far. The General Ombudsman Area is responsible for collecting reports and the Compliance Department is responsible for investigating alleged misconduct. There is, however, a lack of information on how investigations are conducted and sanctions are imposed.

There is also a lack of information about the cooperation between the Governance, Risk and Compliance departments, and there is a lack of clarity regarding the organisation of the Compliance Department and how this department cooperates with other relevant units and committees, such as the General Ombudsman area and Internal Audit Department.

³⁷ Available on the company's website, <http://www.investidorpetrobras.com.br/en/corporate-governance/governance-instruments/code-ethics>.

Finally, it should be mentioned that the former CEO, Maria das Gracas Foster, and five other leading executives, left the company in February 2015. At the same time, the company employed a new CEO, CFO, Chief Investor Relations Officer, Exploration and Production Officer, Engineering Officer, Technology Officer and Procurement Officer. The company has also made major changes to the board of directors and the criteria governing the composition of the board have been revised.

In addition to those former executives who have already admitted liability for corruption, two company employees are allegedly currently being investigated for corruption.

5 The Council on Ethics' assessment

Based on the available documentation, the Council has considered Petrobras against the corruption criteria in the Guidelines with a view to delivering an exclusion or observation recommendation. Firstly, the Council has considered whether there is an unacceptable risk of the company being involved in what would constitute an act of gross corruption under the Guidelines, including whether the alleged corruption has been carried out in a systematic and/or comprehensive manner.

Based on the extensive investigations in Brazil which have thus far resulted in a series of charges and indictments and several judicial decisions where former top management have been convicted of paying and receiving bribes directly related to Petrobras' business, it seems that Petrobras has been involved in actions that qualify as gross corruption. In light of the information available, it also seems that the corruption has persisted within the organisation for many years. The company's largest suppliers had for a long time participated in a cartel whose members were awarded specific contracts pursuant to an agreement. These contracts were over-invoiced and around three per cent of the contract sum was paid as bribes to civil servants and as kickbacks to Petrobras employees. The suppliers paid the bribes either directly to the recipient or via agents. Through these activities, both internal and external tender rules, among other things, were deliberately circumvented. The total amount paid as bribes probably equals several billion US dollars.

In its communication with the Council and in press releases, Petrobras has alleged it is a victim of criminal offences committed by individuals, and refers to the fact that it has the legal position of an aggrieved party in the corruption case in Brazil. In witness statements in several of the court cases that have been held allege that corruption was an integral part of Petrobras' tender processes. It also appears that the senior management's taking of bribes was a key part of the corruption that took place in Petrobras for many years. This was not about one or two employees committing isolated offences. The Council finds that passive corruption on this scale, like active corruption, is an impediment to social and economic development. It creates discrimination, prevents social justice, distorts competition and hinders sustainable economic development.

Based on that which is now known about the case in Brazil, the Council believes that in any case and regardless of the criminal intent, former internal systems must have failed and that defects in the internal controls probably allowed the extensive corruption to take place for so many years. The Council finds that the company had not defined and organised its anti-corruption procedures properly until 2013. If such procedures existed, it is clear that they did not effectively reveal and prevent extensive corruption, thus allowing corruption to flourish freely. The scope of this indicates that the rest of the management in any case should have known what was going on.

This view is further supported by the fact that 11 former executives and mid-level managers of three different departments within the company are directly involved in the case. In addition, two employees are being investigated for corruption. Even further, the criminal cartel consisted of several of Petrobras' most important suppliers.

The Council has assessed whether there is an unacceptable risk of the company again begin involved in comparable conduct.

Petrobras operates in many countries where there is a high risk of corruption. According to Transparency International's Corruption Perception Index, 2014, Angola and Nigeria are for example representing high risk of corruption. Both the oil and gas industry and building and construction industry, where large public contracts are the norm, expose the company to considerable risk. In the Council's opinion, this places special requirements on the company to have in place robust systems and implement anti-corruption measures. The number of corruption allegations against current and former company employees strengthens this requirement further. It is the company that bears the burden of proving that it works in a targeted and efficient fashion to prevent corruption.

The Council has placed emphasis on the fact that a more-or-less entirely new anti-corruption programme was launched in 2013. Several key parts were not introduced until 2014. The company provides information on the main elements of this system, which on the whole is the same information as that available on the company's website. The system apparently contains the elements that such systems are expected to have. However, it seems clear that the implementation of this system is in a start-up phase and there is little publicly available information on how the system is in practice implemented throughout the organisation.

In its assessment, the Council places emphasis on how the company communicates the importance of anti-corruption work both internally and externally. The company has made radical changes to its board and group management after extensive corruption in the company was revealed in 2014. This may in itself signal a new direction. At the same time, the company underlines both in public and to the Council that it is a victim of some individual employees' actions. In light of the extremely comprehensive acts of corruption involving leading Petrobras employees, this gives the impression that the company is denying any liability.

The Council assumes that the high level of attention that the case has received both in Brazil and internationally will probably force the company to take additional steps in the right direction. Reference is made to the fact that Brazilian authorities passed new legislation in 2013 and 2015 which stipulates clearer requirements as to the ways in which companies handle and prevent corruption. The Petrobras case is also a clear signal to the Brazilian people and the rest of the world that there is both an ability and willingness to investigate, prosecute and convict people of acts of corruption in Brazil. In this case, it appears that no one will be left alone – neither senior executives, top politicians nor civil servants. Based on the above, the Council believes that Petrobras has a responsibility for the gross corruption that has taken place in connection with its activities. During the past few years, the company has taken steps to establish an anti-corruption system that reflects international norms and best practice. However, the Council doubts whether these measures will be sufficiently effective and therefore recommends putting Petrobras under observation.

The investigations have not been concluded. The Council will carefully monitor developments in the case over the coming year and reassess the matter in 2016. Should further

cases of gross corruption be revealed in Petrobras' operations in the future and the company cannot satisfy that the anti-corruption programme is being complied with and effectively improved, the condition for exclusion may be met.

6 Recommendation

Due to the risk of corruption involving the company's operations, the Council on Ethics recommends putting Petroleo Brasileiro SA under observation.

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