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## **Council on Ethics' report to Norges Bank on its observation of Petrobras**

In accordance with the Council on Ethics' recommendation, Norges Bank decided on 27 January 2016 to keep the company Petroleo Brasileiro SA (Petrobras) under observation due to the risk of gross corruption, whereupon it asked the Council to monitor developments in the case. This is the Council on Ethics' second annual report on the matter to Norges Bank.

The report is based on how Petrobras has applied and developed its anti-corruption system in 2017 and 2018. The Council has also observed how the company handles the investigation of previous acts of corruption and has kept watch on whether allegations of new incidences of corruption have emerged.

The Council held meetings with representatives of Petrobras in June and September 2017. The company has also submitted its comments on a draft of this report.

## **Key events since the previous annual report was published in March 2017**

Investigations of corruption cases involving Petrobras continued in Brazil and several other countries in both 2017 and 2018. In May 2018, a total of 40 former Petrobras employees were implicated in the *Lava Jato* (Operation Car Wash) investigation.<sup>1</sup> At the beginning of March 2018, a former CEO of Petrobras was sentenced to 11 years in prison for corruption. The individual concerned was found guilty of receiving BRL 3 million from the company Odebrecht in the summer of 2015 in return for favouring that company in future business

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<sup>1</sup> Paraná Portal, 14 May 2018: *Lava Jato já alcançou 40 funcionários da Petrobras*, <https://paranaportal.uol.com.br/politica/operacao-lava-jato/573-petrobras-lava-jato-funcionarios/>.

dealings with Petrobras.<sup>2</sup> The company points out, however, that the person in question did not do anything in return for Odebrecht during the time he was CEO in Petrobras.<sup>3</sup>

Petrobras has been under investigation by the US Department of Justice (DoJ) and the Securities and Exchange Commission (SEC) since 2014.<sup>4</sup> At the end of September 2018, the parties concluded a legal settlement under which Petrobras among other things agreed to pay a fine totalling USD 853.2 million for offences against the Foreign Corrupt Practices Act (FCPA). The DoJ and the SEC each received 10 per cent of this amount, while the remaining 80 per cent went to the Brazilian authorities. As part of the settlement, the company also agreed to continue helping the US authorities with their investigations, as well as improve its compliance programme.<sup>5</sup> According to the agreement, Petrobras “admits, accepts, and acknowledges that it is responsible under United States law for the acts of its officers, directors, employees, and agents” as these are described in the Statement of Facts of the settlement, and that this constitutes a violation of the accounting provisions of the FCPA.<sup>6</sup>

As a result of the corruption case in Brazil, Petrobras has also been the target of civil suits filed by a number of shareholders claiming compensation for financial loss. In a New York court in early January 2018, the company agreed to pay USD 2.95 billion to settle all outstanding and potential claims from shareholders in the USA.<sup>7</sup>

## The company’s anti-corruption efforts since March 2017

### *Corporate governance*

There have been several changes in Petrobras’s board of directors and group management in 2018. In addition to a new CEO, three new board members have been appointed.<sup>8</sup> The company’s CEO since June 2016 resigned at the start of June 2018 and was replaced by the then CFO.<sup>9</sup> A new Chief Governance and Compliance Executive Officer was also brought into the company at the end of May 2018.<sup>10</sup> In addition to these two, a further three people have been appointed to group management positions in 2018. All of those who were members of Petrobras’s board or group management when corruption allegations relating to the

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<sup>2</sup> Reuters, 7 March 2018: <https://www.reuters.com/article/us-brazil-corruption-bendine/ex-petrobras-ceo-bendine-convicted-of-corruption-in-brazil-idUSKCN1GJ37B>; Ministério Público Federal, SENTENÇA, 13.<sup>a</sup> VARA FEDERAL CRIMINAL DE CURITIBA, PROCESSO n.º 5035263-15.2017.404.7000, AÇÃO PENAL: <http://www.mpf.mp.br/grandes-casos/caso-lava-jato/atuacao-na-1a-instancia/parana/denuncias-do-mpf/documentos/bendine-SENT1.pdf/view>.

<sup>3</sup> Letter from Petrobras, 4 December 2018.

<sup>4</sup> Financial Times, 9 November 2014: *US turns up heat with criminal investigation into Petrobras*, <https://www.ft.com/content/82b0d258-6803-11e4-bcd5-00144feabdc0>.

<sup>5</sup> US Department of Justice, 27 September 2018: *Petróleo Brasileiro S.A. – Petrobras Agrees to Pay More Than \$850 Million for FCPA Violations*, <https://www.justice.gov/opa/pr/petr-leo-brasileiro-sa-petrobras-agrees-pay-more-850-million-fcpa-violations>.

<sup>6</sup> U.S. Department of Justice, Criminal Division, 26. september 2018: *Re: Petróleo Brasileiro S.A. – Petrobras*, s. 3, <https://www.justice.gov/opa/press-release/file/1096706/download>.

<sup>7</sup> Petrobras, 3 January 2018: *Petrobras Signs Agreement in Principle to Settle Class Action in the U.S.*, <http://www.petrobras.com.br/en/news/petrobras-signs-agreement-in-principle-to-settle-class-action-in-the-u-s.htm>.

<sup>8</sup> Petrobras, Form 20-F 2017, pp. 104-106; Petrobras, 26 April 2018, *Resolutions of the General Shareholding Meeting Extraordinary and Ordinary*, <http://www.investidorpetrobras.com.br/en/corporate-governance/shareholdersu-meeting>.

<sup>9</sup> Petrobras, 1 June 2018: *Appointment of the new CEO*, <http://www.investidorpetrobras.com.br/en/press-releases/appointment-new-ceo-0>; Petrobras, 4 June 2018: *Petrobras new Chief Executive Officer (CEO) election*, <http://www.investidorpetrobras.com.br/en/press-releases/petrobras-new-chief-executive-officer-ceo-election>.

<sup>10</sup> Petrobras, 21 May 2018: *Chief Governance and Compliance Executive Officer*, <http://www.investidorpetrobras.com.br/en/press-releases/chief-governance-and-compliance-executive-officer>.

company were first uncovered, have since been replaced. This fact is also noted by the US DoJ in connection with the legal settlement entered into at the end of September 2018.<sup>11</sup>

Brazil's new law on corporate governance in wholly and partly state-owned companies (the State-Owned Enterprises Act) – *Lei N° 13.303, de 30 de Junho de 2016* – came into effect on 1 July 2016.<sup>12</sup> Among other things, the law sets out new qualification requirements for board members and senior executives in such companies. In brief, appointees are required to have an academic background and industry experience appropriate to the areas in which they will be working at the companies. Furthermore, it is not permitted to appoint anyone to the boards or managements of these companies who has or may develop a conflict of interest with respect to the company. This includes anyone holding key political positions – both within the government administration or in political parties (Article 17).

Although Petrobras's previous CEO was indirectly appointed by the country's president, through the majority of the members of Petrobras' board of directors, the company discloses that the Governance & Compliance Department performed a thorough background check before he was formally appointed to the position. Since July 2015, the company has also established a Remuneration and Succession Committee, which as of October 2016, has been enhanced to an Appointment, Remuneration and Succession Committee, to handle, among other issues, the appointment of board members.<sup>13</sup> The minutes of the committee's meetings are publicly available, so it can be seen whether the committee's recommendations are accepted or not. According to Petrobras, provisions relating to the background and competence of board members and senior executives more stringent than those laid down in the Brazilian State-Owned Enterprises Act have also been included in the company's By-Laws.<sup>14</sup>

The present board of directors will, in principle, serve until April 2020. At the same time, the majority of board members are appointed by the Brazilian state, which is Petrobras's controlling shareholder.<sup>15</sup> Particularly following presidential and parliamentary elections in Brazil, which take place every four years, state-appointed board members may be replaced. Through its control of the majority of board members, the Brazilian government can also select the majority of the group management team, who are in turn responsible for the company's day-to-day operations. According to Petrobras, this could lead to the company being obliged to prioritise the Brazilian government's goals rather than the company's own financial and commercial objectives.<sup>16</sup>

The direct influence of politicians over the appointment of senior executives in state-owned companies has been a key factor in several of the major corruption scandals to have hit Brazil in recent years.<sup>17</sup>

## ***Compliance***

In the end of November 2018 Petrobras's Board of Directors approved the cessation of the internal investigation into the allegations of corruption against the company, which was

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<sup>11</sup> US Department of Justice, 27 September 2018.

<sup>12</sup> Lei N° 13.303, de 30 de Junho de 2016: [http://www.planalto.gov.br/ccivil\\_03/\\_ato2015-2018/2016/lei/L13303.htm](http://www.planalto.gov.br/ccivil_03/_ato2015-2018/2016/lei/L13303.htm)

<sup>13</sup> Letter from Petrobras, 4 December 2018.

<sup>14</sup> Meeting with Petrobras, 28 June 2017; Petrobras, Form 20-F 2016, 26 April 2017, p. 130, <http://www.investidorpetrobras.com.br/en/annual-reports/form-20f>; Petrobras Annual Report 2017, p. 119, <http://www.investidorpetrobras.com.br/en/annual-reports/integrated-report/annual-report>.

<sup>15</sup> As at 31 October 2018, seven of the company's ten board members have been appointed by the Brazilian state.

<sup>16</sup> Petrobras, Form 20-F 2017, pp. 27-28.

<sup>17</sup> Guardian, 1 June 2017: *Operation Car Wash: Is this the biggest corruption scandal in history?*, <https://www.theguardian.com/world/2017/jun/01/brazil-operation-car-wash-is-this-the-biggest-corruption-scandal-in-history>.

launched in the autumn of 2014. The same is true for the work of the Special Committee that was established immediately afterwards to monitor, report on and follow up the results and the recommendations of the investigation.<sup>18</sup> Petrobras underlines that it has always cooperated with corruption investigations relating to the company which have been carried out by US and Brazilian authorities.<sup>19</sup> This is largely confirmed by the US authorities, which point out that Petrobras has shared in real time information deriving from the internal investigation, regularly presented the facts of the case, facilitated interviews of and information from foreign witnesses, and voluntarily collected, analysed and collated vast quantities of evidence and information, including translating key documents.<sup>20</sup> The Chief Governance and Compliance Executive Officer now has the overall responsibility for the further follow-up of this work in the company.<sup>21</sup>

By the end of October 2018, Petrobras's internal investigation had resulted in a total of 82 recommendations. These were issued in three rounds, first 32, then a further 30, and finally 20. Of these 64 have been fully implemented so far, two have been cancelled and 16 are being implemented.<sup>22</sup> The board's own Audit Committee first reviews and approves the proposals, after which the Compliance Department is responsible for monitoring and following up their actual implementation.<sup>23</sup>

According to Petrobras, the company received a total of 995 reports of possible fraud or corruption through its whistleblower reporting system in 2017 as a whole. This includes all the companies within the Petrobras group. The company's ombudsman deemed 80 of these reports to constitute a high or very high risk. The company further discloses that approx. 300 administrative sanctions/disciplinary measures were imposed on employees at various levels of the organisation in 2017, in part for non-compliance with the company's rules and guidelines. These measures included 20 dismissals, 95 suspensions and 183 written warnings.<sup>24</sup>

In December 2014, as a temporary preventive measure, Petrobras set up Committees to Analyze the Application of Administrative Sanctions to blacklist supplier companies cited as cartel participants in the Lava Jato investigation. Initially, 32 companies were provisionally banned. In 2015, the suspension was extended to two other companies, totaling 34. The same year the responsibility for monitoring the companies in question was transferred to the Office of the Comptroller General (CGU) in Brazil. In the latter half of November 2018 there were still 15 companies mentioned in the Lava Jato investigation which were prevented from participating in new bidding processes and from signing new contracts with Petrobras.<sup>25</sup>

According to Petrobras, the company performed Integrity Due Diligence (IDD) investigations into 5,640 counterparties in 2017.<sup>26</sup> Suppliers of goods and services to Petrobras have been subjected to such investigations since 2015. With effect from 2017, IDD investigations have also encompassed the company's customers, organisations the company sponsors, potential buyers in sell-off processes and potential business partners.<sup>27</sup>

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<sup>18</sup> Letter from Petrobras, 4 December 2018.

<sup>19</sup> Petrobras, Form 20-F 2017, p. 19, F-15-16.

<sup>20</sup> US Department of Justice, 27 September 2018.

<sup>21</sup> Letter from Petrobras, 4 December 2018.

<sup>22</sup> Letter from Petrobras, 4 December 2018.

<sup>23</sup> Meeting with Petrobras, 28 June 2017.

<sup>24</sup> Petrobras Sustainability Report 2017, pp. 49-51, <http://www.investidorpetrobras.com.br/en/annual-reports/integrated-report/sustainability>.

<sup>25</sup> Letter from Petrobras, 4 December 2018.

<sup>26</sup> Petrobras *Sustainability Report* 2017, p. 47.

<sup>27</sup> Petrobras *Annual Report* 2017, p. 119.

Petrobras discloses that members of the company's board and senior management attended two courses on, respectively, business ethics and the Petrobras Corruption Prevention Program (PCPP) in 2017, which also covered how to deal with conflicts of interest.<sup>28</sup> In that same year, the company provided anti-corruption training to 218 employees in particularly exposed positions, e.g. those involved in procurement processes, as well as 335 other managers. The company also provides online training on its code of conduct to all employees. The e-learning course recorded 59,000 visits during 2017. In December 2017, Petrobras estimated that around 96 per cent of its employees had taken this course.<sup>29</sup>

## **The Council on Ethics' assessment**

In its previous observation report, the Council on Ethics concluded that Petrobras had substantiated that the anti-corruption efforts initiated by the company in 2015 had continued in 2016, and that the company had tangible plans for further activities in this area. The Council's dialogue with the company in 2017, as well as its published reports, seem to confirm that efforts to further develop and implement the company's anti-corruption programme have also continued in 2017 and 2018.

The company's disclosures relating to reports of possible misconduct it has received, the way the ombudsman has dealt with them and the sanctions/disciplinary measures imposed in consequence of rule violations all indicate that Petrobras has come a long way towards the establishment of an operative corruption reporting and sanctions system. The company also seems to have established an extensive apparatus for the performance of due diligence on suppliers, customers and other counterparties, including the companies encompassed by the *Lava Jato* investigation. The information available on the company's programmes and activities with respect to the provision of anti-corruption training for board members, senior executives, other managers and employees also indicates that Petrobras is emphasising the development of an anti-corruption culture within the organisation. The scope of all the initiatives here mentioned also indicates that Petrobras in general is devoting considerable resources to this work. The Council takes this to be an expression of the continued high priority that the company is giving to preventing, detecting and dealing with corruption.

The Council on Ethics notes that in 2018 Petrobras has entered into a legal settlement with the US DoJ with respect to allegations of corruption. Among the terms of the settlement, Petrobras must pay a fine totalling USD 853.2 million. In the settlement Petrobras acknowledges that the company has violated the accounting provisions of the FCPA. At the same time, the US DoJ confirmed that Petrobras has cooperated fully with its investigation.

The Council also notes that a former CEO, who was appointed in 2015, after the *Lava Jato* investigation had begun, has been convicted of corruption. Following this, however, the company has introduced new guidelines and procedures for the recruitment of board members and senior executives with the right background and experience.

At the same time the Council notes that the Brazilian state, as the controlling shareholder, still appoints the majority of board members and thereby also the majority of the company's group management team. Politicians' direct influence over the appointment of senior executives in state-owned companies has been a key factor in several of the major corruption scandals that have rocked Brazil in recent years. The Council notes the introduction in recent years of anti-corruption legislation that is enforced by the Brazilian judicial system, and presumes that these measures have reduced the risk of corruption. However, in the Council's opinion there is still a high risk of corruption in Brazil.

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<sup>28</sup> Petrobras, *Form 20-F 2017*, p. 167.

<sup>29</sup> Petrobras *Sustainability Report 2017*, p. 47; Petrobras *Annual Report 2017*, p. 117.

Even though Petrobras has shown considerable ability and willingness to prevent, detect and deal with corruption, the Council also believes that a certain weight must be attributed to the fact that the latest serious corruption case in the company occurred after investigations into corruption had begun. Hence, the Council considers that observation of Petrobras should continue, and with a particular focus on the kinds of changes that may take place in the governance of the company.

The Council on Ethics will continue to observe Petrobras's anti-corruption efforts, partly by engaging in a dialogue with the company. The Council will also monitor whether details of new cases of gross corruption within the company come to light, and what, in that case, the company does in response.

Yours sincerely,

Johan H. Andresen  
Chair of the Council on Ethics