CLIENT ALERT

Brazilian Oil Giant Petrobras Settles Largest-Ever FCPA Enforcement Action for $1.78 Billion

October 1, 2018

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On September 26, 2018, Petróleo Brasileiro S.A. ("Petrobras" or the "Company"), the Brazilian majority state-owned oil and gas company, settled Foreign Corrupt Practices Act ("FCPA") charges with the U.S. Department of Justice (the "DOJ") and the Securities and Exchange Commission (the "SEC") for a total of $1.78 billion. The settlements provide that certain amounts due to the DOJ and SEC will be offset by amounts paid by Petrobras to Brazilian authorities and paid to settle related shareholder litigation in the United States. Petrobras has American Depositary Shares ("ADSs") registered with the SEC and traded on the New York Stock Exchange and is therefore subject to the FCPA as an "issuer."

Petrobras entered into a non-prosecution agreement ("NPA") with the DOJ that included a criminal penalty of $853.2 million for knowingly and willfully failing to keep accurate books and records and implement appropriate internal financial and accounting controls by "facilitating payments to politicians and political parties in Brazil."[1] Under the NPA, Petrobras will pay 10 percent, or $85.32 million, of the criminal penalty to the DOJ and another 10 percent to the SEC. Petrobras will pay the remaining 80 percent of the criminal penalty, or $682.56 million, to authorities in Brazil.

[1] Non-Prosecution Agreement with Petróleo Brasileiro S.A. – Petrobras (Sept. 26, 2018), available at: https://www.justice.gov/opa/press-release/file/1096706/download

In settling the companion SEC enforcement action, Petrobras agreed to disgorge $933.47 million, including over $222 million in prejudgment interest.[2] The disgorgement amount will be reduced by the amount of any payments Petrobras makes to the settlement fund in a related class action shareholder lawsuit, which the Company has agreed to settle for $2.95 billion.[3] The SEC settlement includes not only FCPA books and records and internal controls charges but also charges of securities fraud in connection with the offer or sale of securities and in relation to providing incomplete or inaccurate information in its annual report.[4]

These resolutions represent the latest step in the sprawling investigation of corruption in Brazil, launched in 2014, known as Operation Car Wash. Petrobras has long been recognized as being at the center of this investigation and many of the facts underpinning the Petrobras settlements parallel those detailed in other actions, including the 2016 FCPA settlements of Brazilian construction company Odebrecht S.A. and its chemicals subsidiary, Braskem S.A.[5]

The Corrupt Scheme

The NPA's statement of facts and the SEC order detail that a number of high-ranking Petrobras executives, including members of its Executive Board and Board of Directors, facilitated the payment of hundreds of millions of dollars in bribes to Brazilian politicians and political parties. In particular, these Petrobras executives required certain Company contractors to pay 1 to 3 percent of the value of the contracts as bribes and kickbacks to Brazilian government officials and the Petrobras executives themselves. The NPA estimates that more than $2 billion in corrupt payments were made under this scheme. The bribe money was funneled through "fictitious costs," such as sham consultancy agreements. Bribes were paid, among other reasons, "to stop a parliamentary inquiry into Petrobras contracts." In addition, "millions of dollars [were paid] to the campaign of a Brazilian politician who had oversight over the location where one of Petrobras's refineries was being built."

The Company acknowledged that these executives then falsified Petrobras's books and records, including Sarbanes-Oxley certifications, to conceal the bribe payments from investors and regulators, while also artificially inflating the Company's financial statements and causing misstatements in Petrobras's Form 20-F filings. The Company also admitted that "certain executives failed to implement internal financial and accounting controls in order to continue to facilitate bribe payments to Brazilian politicians and Brazilian political parties."

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2 Securities and Exchange Commission, *In re Petróleo Brasileiro S.A. – Petrobras*, Administrative Proceeding File No. 3-13509 (Sept. 27, 2018).

3 *In re Petrobras Securities Litigation*, No. 14-cv-9662 (S.D.N.Y.).

4 15 U.S.C. §§ 77q(a)(2)-(3).

5 *United States v. Odebrecht S.A.*, Cr. No. 16-643 (RJD), Plea Agreement, Attachment B (E.D.N.Y. Dec. 21, 2016); *United States v. Braskem S.A.*, Cr. No. 16-644 (RJD), Plea Agreement, Attachment B (E.D.N.Y. Dec. 21, 2016).

Largest FCPA Penalty

The bribery scheme described in the settlement documents and related $1.78 billion settlement amount constitutes the largest FCPA enforcement action resolution in history, far surpassing the 2017 settlement reached with Sweden's Telia Company AB to pay total penalties of $965 million to resolve bribery offenses in Uzbekistan.

The amount of Petrobras's settlement reflects that the Company did not voluntarily disclose the matter to the DOJ and SEC but the Company received full credit for cooperation and remediation and, accordingly, in line with the DOJ's FCPA Enforcement Policy, it received a 25 percent discount from the otherwise applicable sentencing guideline range.[6] Among the aspects of cooperation cited in settlement documents were the Company's thorough investigation, sharing of facts discovered in the investigation, "real time" disclosure of relevant factual findings to the DOJ and SEC, witness availability, and production and translation of relevant documents. The DOJ and SEC also noted that the Company removed "any of the individuals known to the Company to be implicated in the conduct at issue," including replacing its Board of Directors and Executive Board, and establishing procedures for disciplining employees.

Petrobras also received credit for significant improvements to its compliance program, including (i) creating a Division of Governance and Compliance ("DGC"), (ii) mandating that "the [head] of DGC cannot be terminated without the affirmative vote of a Board member representing minority shareholders," (iii) creating a "four eyes" approval policy that requires second review by supervisors in different reporting lines for "substantive decisions," (iv) implementing a confidential reporting hotline, (v) developing new hiring and promotion procedures, (vi) requiring compliance training for all employees, (vii) creating an Ethics Committee to promote ethical principles within the company, (viii) centralizing the company's procurement function while segregating procurement duties, and (ix) implementing a risk-based due diligence system for contractors, along with other policy and procedure improvements.

Prosecution of a Foreign State-Owned Entity

The Petrobras FCPA prosecution is unique in that Petrobras is majority-owned by the Brazilian government and considered by the DOJ and SEC to be an "instrumentality" of the Brazilian government whose employees themselves are considered "foreign officials."[7] Perhaps at least in part in deference to Petrobras's unique status, the DOJ and SEC did not require the appointment of an independent compliance monitor as part of the settlement. The DOJ in particular noted that following the settlement, Petrobras would continue to be subject to oversight by Brazilian authorities. The NPA also noted that by agreeing to the settlement, Petrobras "does not prospectively waive any arguments that, as an

6 United States Department of Justice, *Justice Manual*, 9-47.120 (2018).

7 In other enforcement actions, prosecutors have considered Petrobras employees to be "foreign officials." *See United States v. Odebrecht S.A.*, Cr. No. 16-643 (RJD), Plea Agreement, Attachment B, ¶¶ 14-16 (E.D.N.Y. Dec. 21, 2016).

instrumentality of the Republic of Brazil, it is protected by sovereign immunity from criminal prosecution in the United States, and it reserves the right to assert this argument in any future prosecution or civil action by the United States."

Compliance Lessons

The compliance program remediation cited by the DOJ and SEC in the settlement documents offers some guidance on the compliance controls that these regulators view as important and would expect to find when reviewing similarly situated companies. In particular, the DOJ and SEC expect:

- Operation of an independent compliance function with significant standing, authority, and independence within the company;
- Approval procedures that mitigate the opportunity for a single individual, or small number of individuals, to misuse company funds or assets;
- Management of procurement and vendor selection processes that includes senior-level oversight by independent personnel removed from the costs and benefits of underlying engagements; and
- A strong system for performing and evaluating due diligence on prospective third party partners, particularly those that are high risk.

Policy on Piling On

On May 9, 2018, the DOJ announced its "Policy on Coordination of Corporate Resolution Penalties," which instructed prosecutors in parallel or joint investigations to "coordinate with one another to avoid the imposition of duplicative fines, penalties, and/or forfeiture against the company."[8] This policy was promulgated amid a trend toward greater cooperation and information sharing among prosecutors and regulators from different countries. For example, in 2016, VimpelCom Limited settled with the DOJ, SEC, and Dutch prosecutors and paid half of its $795 million in penalties to the Dutch. In September 2017, the DOJ's and SEC's FCPA settlement with Telia Company AB provided that part of its $965 million in criminal penalties and disgorgement would be paid to Swedish and Dutch authorities. Likewise, in December 2017, Keppel Offshore & Marine Ltd. settled FCPA charges by agreeing to a $422 million penalty, with half the penalty payable in Brazil and a quarter of the penalty payable in Singapore.[9]

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8 United States Department of Justice, *Justice Manual*, 1-12.100 (2018).

9 *United States v. VimpelCom Ltd.*, No. 16-CR-00137 (ER), Information (S.D.N.Y. Feb. 18, 2016); *United States v. Telia Company AB*, No. 17-CR-00581 (GBD), Deferred Prosecution Agreement (S.D.N.Y. Sept. 21, 2017); *United States v. Keppel Offshore & Marine Ltd.*, No. 17-CR-697 (KAM), Deferred Prosecution Agreement (E.D.N.Y. Dec. 22, 2017).

The Petrobras resolution continues this trend, and marks the second nine-figure FCPA resolution under the DOJ's official policy against "piling on." In June 2018, the DOJ assessed a $585 million criminal penalty against Société Générale S.A., with half of that amount to be paid to the French enforcement agency, Parquet National Financier.[10] Here, presumably in recognition of the fact "that Petrobras is a Brazilian-owned company that entered into a resolution with Brazilian authorities and is subject to oversight by Brazilian authorities," the DOJ settlement provides for 80 percent of the total criminal penalty, or $682.5 million, to be paid to Brazilian authorities. This policy is expected to remain in place for the time being. Consequently, corporations facing a potential enforcement action from the DOJ or SEC should consider engaging with regulators from other interested jurisdictions, if the circumstances warrant, before entering into any resolution with U.S. authorities. The SEC's decision to credit Petrobras for money paid to a class action settlement fund against the entire amount of disgorgement and interest—over $933 million—is further evidence of the potential benefit in seeking a global resolution of FCPA-related matters.

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[10] *United States v. Société Générale S.A.*, No. 18-CR-253 (DLI), Deferred Prosecution Agreement (E.D.N.Y. June 4, 2018).