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Brazil's “Operation Car Wash”: Impacts on Petrobras and the Broader Brazilian Economy

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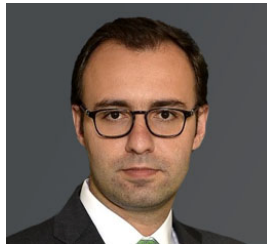
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Speakers



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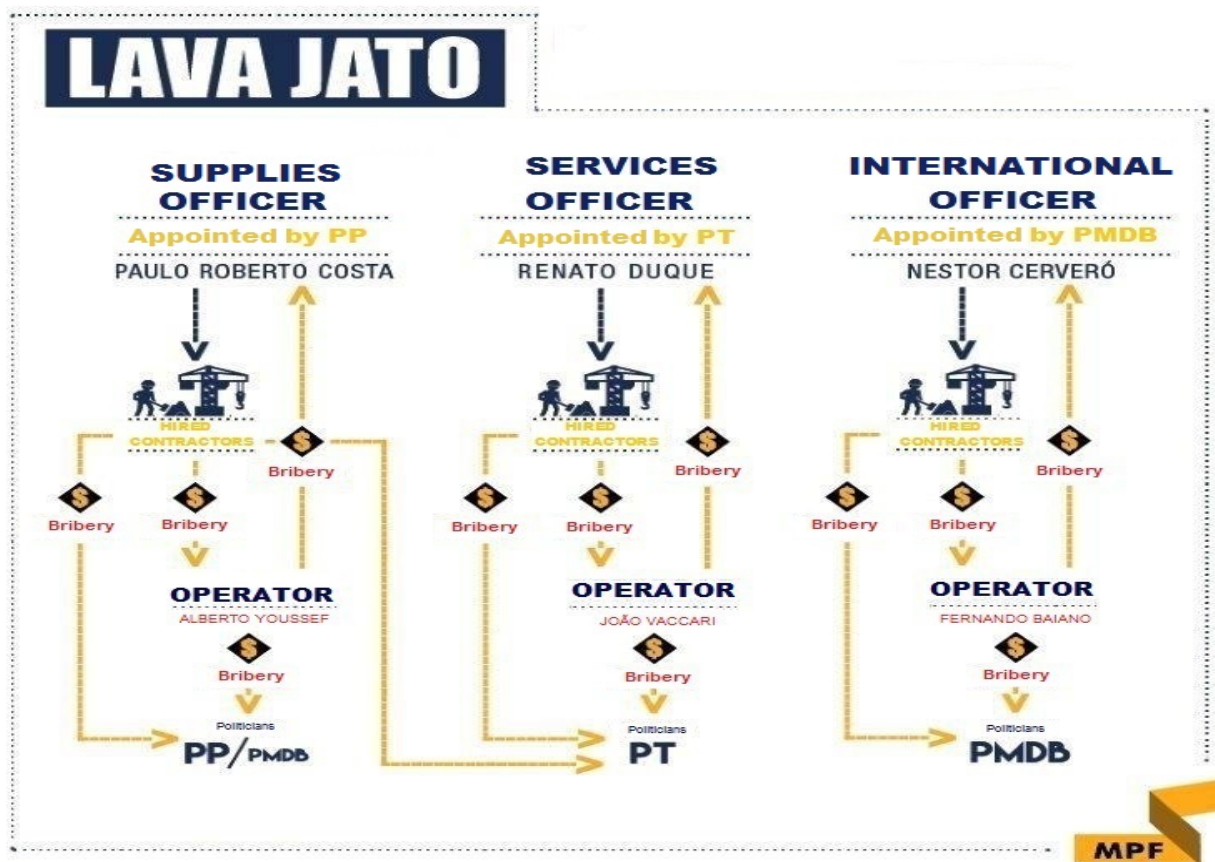
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The Calm Before the Storm

- **July 2009** - “Operation Car Wash” is launched
 - Focused on illegal money brokers; first phase was named “Car Wash” because of the practice of using gas stations for money laundering
 - The name “Car Wash” has stuck, although each phase has its own codename (“Dolce Vita”, “Bidone”, “Doomsday”, “My Way”)
- **March 2014** – “Operation Car Wash” becomes public, but it attracts little attention
- **March-October 2014** – Behind the scenes, however, a senior Petrobras executive and a black market money dealer enter into plea agreements with Brazilian authorities and begin cooperating

The Alleged Scheme



The Investigation Emerges

- **November 2014** – Petrobras' auditor refuses to sign-off on its third quarter earnings
- **November 12, 2014** – SBM Offshore, a Dutch supplier of offshore oil vessels, settles a bribery case involving \$240 million of payments to Petrobras employees
- **November 14, 2014** – “Operation Doomsday”
 - Brazil's Federal Police execute 45 dawn raids
 - Police arrest several senior executives at major Brazilian companies, including from Petrobras and major construction companies
 - Police seize thousands of documents to support the criminal investigations and pending charges

The Investigation Unfolds

- ***December 8, 2014*** – Minister of the Office of the Comptroller General resigns
- ***December 10, 2014*** – Attorney General recommends removal of Petrobras' management
- ***December 2014*** – Multiple indictments filed; defendants include high-ranking executives of major Brazilian construction companies

The Investigation Unfolds

- ***December 10, 2014*** – The Special Congressional Investigations Committee issued report on four issues:
 - Pasadena Refinery: Committee concluded that the \$800 million loss in the refinery transaction was the result of market conditions, not bribery or other improper conduct
 - SBM Offshore Corruption Allegations: Committee concluded that there was strong evidence of corruption
 - Safety in Platforms: Committee rejected allegations that Brazil rushed delivery of platforms to improve its reported trade balance, but acknowledged that safety issues resulted from the transactions
 - Abreu e Lima Refinery: Committee concluded that the lack of public bidding led to cost overruns and suggested a change in the regulation of Petrobras Contracts

The Investigation Unfolds

- **December 10, 2014** – Report recommends further investigations of 20 companies:

| | |
|---------------------------------------|--------------------------------------|
| Andrade Gutierrez S.A. | Grupo Odebrecht |
| Astromarítima Navegação S.A. | Hope Recursos Humanos |
| Clyde Union Imbill | IESA Projeto, Equip. e Montages S.A. |
| Consórcio RNEST | Jaraguá Equipamentos |
| Construções e Comércio Camargo Corrêa | Mendes Junior Engenharia S.A. |
| Construtora OAS S.A. | Metasa S.A. Indústria de Metais |
| Construtora Queiroz Galvão S.A. | Muranno Brasil Marketing Ltda |
| Engevix Engenharia S.A. | OAS Engenharia e Participações |
| Galvão Engenharia S.A. | Toyo Setal Emp. Ltda. |
| Gandra Brokerage | UTC Engenharia |

The Investigation Unfolds

- **December 17, 2014** – Opposition parties vote against the Report
- **December 29, 2014** – 23 companies related to “Operation Car Wash” are temporarily banned from contracting with Petrobras and suspended from participating in Petrobras’ bids

| | | |
|--|--------------------------------------|---------------------------------|
| Alusa Engenharia S.A. | Fidens Engenharia S.A. | OAS Engenharia e Participações |
| Andrade Gutierrez S.A. | Galvão Engenharia S.A. | Grupo Promon |
| Construções e Comércio Camargo Corrêa | GDK S.A. | TOYO SETAL EMPREENDIMENTOS LTDA |
| Carioca Christiani Nielsen Engenharia | Grupo Odebrecht | Skanska |
| CONSTRUCAP-CCPS Engenharia e Comércio S.A. | IESA Projeto, Equip. e Montages S.A. | Techint Engenharia e Construção |
| Construtora Queiroz Galvão S.A. | Jaraguá Equipamentos | Tomé Engenharia e Transportes |
| Egesa | Mendes Junior Engenharia S.A. | UTC Engenharia S.A |
| Engevix Engenharia S.A. | Grupo MPE | |

The Investigation Unfolds

- **January 14, 2015** – Brazil arrests the former director of Petrobras's international division
- **January 28, 2015** – Petrobras releases a third-quarter non-audited reports two months after the deadline and after PWC declined to sign off on the results
- **February 4, 2015** – Petrobras CEO Graça Foster and five other officers resign
- **February 5, 2015** – Brazil launches “Operation My Way”
 - 62 warrants issued to arrest and question suspects, to freeze assets, and to seize corporate and personal documents

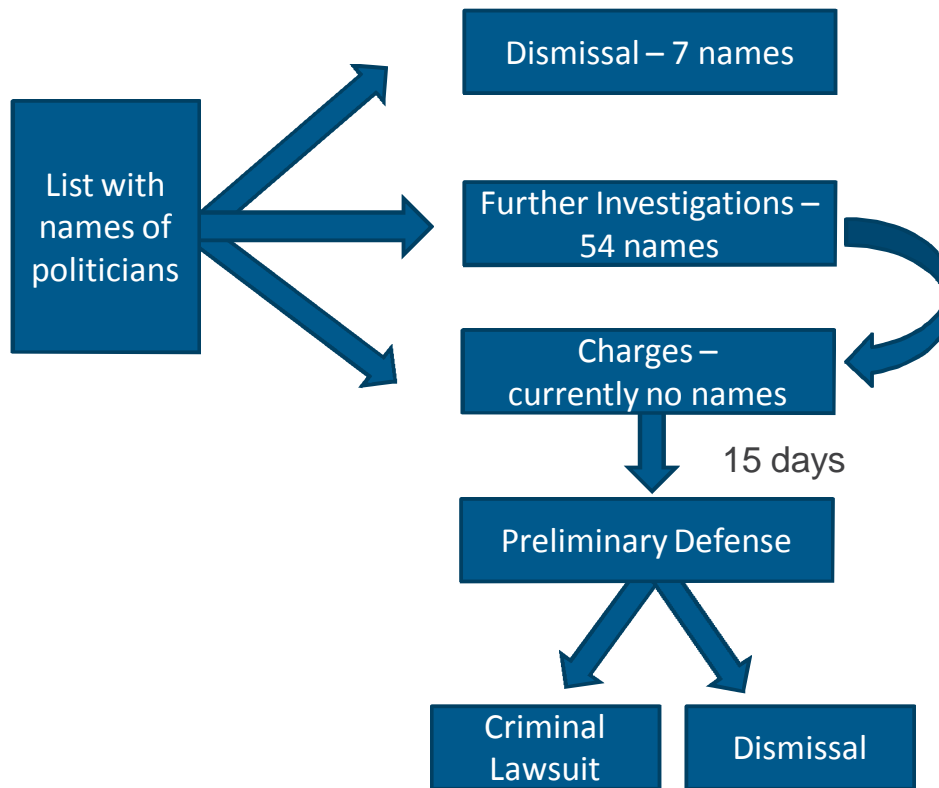
The Investigation Unfolds

- **February 5, 2015** –Labor Party Treasurer is detained for questioning after former Petrobras executive accuses him of receiving illegal donations
- **February 11, 2015** –Federal Audit Committee (“TCU”) rules that all leniency agreements executed by the federal government are subject to the oversight of the TCU
- **February 20, 2015** – Two construction companies formally request leniency under the newly-enacted Clean Company Act
- **February 2015** – CGU suggests that it will seek leniency agreements with construction companies to save jobs

The Investigation Unfolds

- **February 21, 2015** – Federal Prosecutors seeks to prevent leniency agreements executed at federal level by Office of the Comptroller General alleging it could be harmful to public interest
- **February 27, 2015** – Two construction company executives enter into plea agreements, becoming the 14th and 15th people to admit guilt
- **March 2015** – New Congressional Investigations Committee issues more than 450 subpoenas for documents and testimony
- **March 3, 2015** – Brazil's Attorney General files investigation requests before Supreme Court against sitting politicians
 - Indicts Presidents of Congress (Senate) and House of Representatives

Procedure at the Supreme Court



Procedure at the Supreme Court

Criminal investigations and lawsuits are judged by the 2nd Panel of the Court



Teori Zavascki

Appointed by Dilma
Roussef
President of the Panel
Reporter of the Case



Celso de Mello

Appointed by José
Sarney



Gilmar Mendes

Appointed by
Fernando Henrique
Cardoso



Carmen Lucia

Appointed by Lula
Vice-President of
Supreme Court



Dias Toffoli

Appointed by Lula

The Investigation Continues

- **March 13, 2015** – Former and current Governors of the State of Rio de Janeiro (Sergio Cabral and Luiz Fernando Pezão) and Governor of the State of Acre are investigated at the Superior Court of Justice (STJ)
- **March 16, 2015** – Operation “What Kind of Country is This?” (“*Que país é esse?*”)
 - Former Petrobras Supplies Officer is arrested
 - PT Treasurer (João Vaccari) is charged with corruption
 - Several dawn raids

The Investigation Continues

- **March 2015** – The investigations continue on six (6) fronts:
 - At the Supreme Court (Congressmen and Ministers)
 - At the Superior Court of Justice (State Governors)
 - At the Curitiba Federal Court (all other individuals)
 - At CGU (Corporate violations of the CCA)
 - Possibly at CADE (cartel formation)
 - At the Congressional Investigations Committee (all)
- **March 15, 2015** –
 - More than two million demonstrate in 33 cities against corruption and the government
 - Government promises legislation against corruption

Economic Consequences of Investigation **Petrobrás suppliers**

- Almost **two dozen entities** have been identified as subjects of the investigation and **suspended** from doing business with Petrobrás.
 - These entities face potentially **severe economic challenges** on several fronts, including loss of significant revenue streams, payment of large fines, difficulty obtaining affordable credit and higher litigation and restructuring expenses
 - While Petrobrás has already made it public that it will not retain any entity that is on the “List of Banned Companies” in future supply agreements, **other construction companies not included in the list have been mentioned in the Carwash Operation**

Economic Consequences of Investigation

Petrobrás suppliers

- Companies which have filed for bankruptcy
 - **Alumini Engenharia S.A.**
 - Not included in this banned companies list, but is mentioned in the Carwash Operation.
 - Just filed for bankruptcy; restructuring approximately BRL 1 billion in debts
 - **Inepar Group (Iesa)** had already filed prior to the Carwash Operation emerged
 - The company's main contract (70% of its revenues) was for the construction of FPSOs for Petrobrás
 - Petrobras terminated this agreement after the investigations became public
 - Approximately 2,000 employees lost their jobs
 - Challenge to avoid liquidation

Economic Consequences of Investigation **Petrobrás suppliers**

- Suppliers' default under existing agreements
- No revision for existing contracts
- Closing of operational sites
 - Risk to assets (equipments, parts for construction, etc.) in the site
 - Deterioration of assets and guarantees lost
- Dismissal of thousands of employees
 - Local crisis in remote cities
 - Responsibility of Petrobrás as beneficiary of the service provided for all labor claims

Economic Consequences of Investigation **Petrobrás suppliers**

- Risk to the O&G business: which companies would be Petrobrás able to retain?
 - Most important construction companies are involved in the Carwash Operation
 - Possible opportunity for foreign investors
 - Who would invest?
 - Uncertainties of investigation process and financial risks to the company or the new investor
 - Reputational risks
- *Petrobrás announces USD 13.7 billion divestment plan for 2015-2016*

Brazilian state-run oil company Petrobrás said today that its executive board had approved the company's two-year (2015/2016) divestment plan for a total USD 13.7bn.

Economic Consequences of Investigation **Petrobrás suppliers**

- Payment retention and severe financial crisis for the companies
 - I.E. *President Rousseff meets with officials to discuss rescuing Petrobras contractors from default*
- Companies which are facing financial/reputational trouble in accordance with specialized press:
 - **Schahin Group**
 - **OAS Group**
- Likelihood of filing for bankruptcy or liquidation will depend on the size of the company and whether their revenues rely in the public sector only (not only Petrobrás)

Economic Consequences of Investigation

Petrobrás suppliers – Recent downgrades

Senior secured notes of vessels linked to Petrobras downgraded by Moody's

Moody's Investors Service (Moody's) downgraded the ratings of the senior secured notes of the following six issuers:

SBM Baleia Azul

Senior secured global notes due September 2027 downgraded to Ba3 from Ba1; approximately USD 400m of debt affected.

Lancer Finance Company

Senior secured global notes due July 2016 downgraded to B1 from Ba1; approximately USD 80m of debt affected.

Schahin II Finance Company

Senior secured global notes due September 2022 downgraded to B1 from Ba1; approximately USD 675m of debt affected.

QGOG Atlantic / Alaskan Rigs

Senior secured global notes due July 2018 downgraded to B1 from Ba1; approximately USD 372m of debt affected.

Odebrecht Drilling Norbe VIII/IX

Senior secured global notes due June 2021 downgraded to B2 from Ba1; approximately USD 1.275bn of debt affected.

Odebrecht Offshore Drilling Finance

6.75% and 6.625% senior secured global notes due in October 2022 downgraded to B2 from Ba1; approximately USD 2.151bn of debt affected (USD 2.122bn after March 2nd).

All ratings remain on watchlist under review for possible downgrade.

Redd Latin America

Economic Consequences of Investigation

General economic situation

- Brazilian companies lost space in international capital markets
- Long crisis in the ethanol business and crisis in the power sector due to governmental intervention in energy price – crisis in the whole energy sector in Brazil
- The world is looking for the outcome of this investigation
 - Reputation of Brazilian institutions
 - I.E. Eike's assets and the judge in charge of its case
- “Wave effect” in suppliers of suppliers, banks, investment funds, etc. – possible recession (decrease in the GDP)

International Cooperation: The New Normal?

[W]e increasingly find ourselves shoulder-to-shoulder with law enforcement and regulatory authorities in other countries. Every day, more countries join in the battle against transnational bribery. And this includes not just our long-time partners, but countries in all corners of the globe.

-- Assistant Attorney General Leslie R. Caldwell (Nov. 19, 2014)

U.S.-Brazilian Cooperation

- U.S. and Brazil have historically maintained deep enforcement relationships
 - Brazil is DOJ's most prolific MLAT customer
 - Formal and informal cooperation and coordination
 - Coordinated money tracing and asset forfeiture efforts

U.S.-Brazilian Cooperation

- The U.S. will actively cooperate with Brazil
 - Legal advice and practical support
 - Proactive assistance with discovery
 - Document Subpoenas
 - Witness Interviews
 - Tracing the illicit funds
 - Asset freezes / restraining orders
 - Asset forfeitures / repatriation

The Potential for U.S. Enforcement Actions

- All the facts aren't known yet, but potential issues include
 - Is Petrobras a governmental entity?
 - Who was paying bribes?
 - Construction companies?
 - Other Petrobras counterparties?
 - Were the alleged payments made to obtain or retain business?
 - Does the U.S. have jurisdiction over any of the players? On what theory or theories?
 - Will the U.S. prosecute if Brazil brings charges itself?

Thank You

For questions, please reach out to any of us:

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