
Political Capture in the Petrobras Corruption Scandal: The Sad Tale of an Oil Giant

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In academic debates about the government's role in the economy, Petrobras used to be known as the darling exception to the overwhelming empirical evidence against state-owned enterprises (SOEs). Such corporations are notorious for their lack of efficiency, vulnerability to political abuse, and draining of state revenue. However, since March 2014, Brazilians have been inundated with revelations of Petrobras-linked corruption that are considered unprecedented, even for a country so accustomed to corruption scandals. Until this point, experts in Brazilian politics considered Petrobras one of the few successful cases of bureaucratic insulation against political exploitation. However, the company's corruption investigation has cast doubt on the capacity of SOEs to insulate themselves from politicians, who see these companies as their hens with golden eggs. For Brazilians, the Petrobras case has also led to the realization that kickbacks and other bribery practices are not just likely, but the norm, in business deals in Brazil.

Dubbed "Operação Lava Jato" (or the "Car Wash Investigation") Brazil's federal police officially launched its investigation on March 17, 2014, after being tipped off by analysts from the Council for Control of Financial Activities (COAF), the country's financial intelligence unit. The analysts noticed frequent bank account transactions involving large sums

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of money between companies that did business with Petrobras, despite their evident lack of technical or operational expertise.¹ The scale of the scandal is as massive as the state-controlled oil corporation itself, which, until 2013, figured among the fifteen largest oil companies in the world and generated USD 130 billion in revenue annually.² Numbers in this

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scandal keep changing with every new revelation, but as of the writing of this article, Brazil's Federal Court in Paraná, a southern state, has indicted thirty-nine suspects in the case, twenty-five of whom are now in prison. Twenty-five companies are also under investigation. In total, Petrobras' losses to the massive kickback and money laundering schemes are estimated to be BRL 88 billion (USD 31.5 billion).³ Stocks held by the company's shareholders, on

the other hand, had lost on average 50 percent of their market value since September of 2014.⁴

Due to the idiosyncrasies of the Brazilian judicial system, the names of accused politicians and sitting government officials that surfaced in the testimony of the defendants in the lower courts could not initially be revealed to the public. After weeks of speculation, however, Brazilians finally had the chance to learn the names of politicians who will be investigated by the Supreme Federal Court, announced on national broadcast on March 6, 2015. The list includes fifteen senators, twenty-one Congress members, thirteen former Congress members, and one former governor. Among the most well-known and politically-relevant individuals involved in the scheme are Fernando Collor de Mello, currently a senator and formerly Brazil's president (1990 to 1992), who resigned from office to escape impeachment procedures due to corruption allegations, and former Governor Roseane Sarney, daughter of José Sarney, Brazil's former president (1985 to 1990). Other names include the Senate President, the President of the House of Representatives (third in line for the Brazilian presidency), President Rousseff's former Chief of Staff and Finance Minister under President Luiz Inácio Lula da Silva, a former Minister of Energy in the Lula and Dilma administrations (2008 to 2015), and yet another of Rousseff's former Chiefs of Staff (2011 to 2014).

The political party with the highest number of politicians on the list, the Progressive Party (PP), was co-founded by Paulo Maluf, currently a

member of Congress and formerly the mayor and governor of São Paulo. Maluf was indicted in the United States in 2007 for money laundering through public construction kickback schemes. That indictment by a New York state court earned him inclusion on Interpol's Red Notice list.

The government's investigation has benefited significantly from plea bargains made with some of the suspects, which have put tremendous pressure on other suspects to cooperate with the authorities. Successive revelations resulting from these plea bargains have done considerable damage to Petrobras' image as a well-run multinational, to the reputation of Brazil's burgeoning business environment, and to any respect the public still had for the country's political establishment. One plea bargain was particularly alarming, because it revealed the massive size of the corruption scheme that would be soon uncovered: Pedro Barusco, a second-tier engineering manager, agreed to give back USD 100 million in corrupt transactions deposited overseas in exchange for a more lenient sentence. That amount made Gilmar Mendes, Brazil's Federal Supreme Court Minister, remark that the Petrobras scandal makes other corruption cases (appear) more appropriate for the small claims court.⁵

“OPERAÇÃO LAVA JATO”

From the time that the Lava Jato investigation was first announced, many were impressed by its scope. It reached seventeen cities in seven states throughout the country and initially looked into the laundering of BRL 10 billion (USD 3.5 billion). Once the Federal Police identified the main suspects, forty-seven arrest warrants were issued. At first, only five suspects entered into plea bargaining agreements. Those suspects' testimonies were so consistent and rich in details—with names of Petrobras employees, outside companies and their staff members, money changers, banks, and political parties, along with amounts paid or received—that other suspects succumbed to the pressure to cooperate with the authorities.

Time is of the essence for a suspect who is considering a plea bargain. The longer the passage of time, the less valuable a defendant's testimony is likely to be, which will in turn affect the authorities' willingness to reduce his or her sentence. The Brazilian authorities' strategy to incentivize the suspects' confessions has been very successful. By the end of February 2015, almost a year after the launch of the investigation, a total of fifteen suspects had capitulated.

The testimony of Paulo Roberto Costa, a former Petrobras Supply Director, was one of the first to shed light on the political parties' control

over the company's board of directors and how the scheme's proceeds were divided among those involved. Historically, members of the company's board have been nominated by the office of Brazil's president. Starting from the Luiz Inácio Lula da Silva administration, in 2003, nominations to the board were dominated by three parties from Lula's political coalition: the Workers' Party (PT), the Brazilian Democratic Movement Party (PMDB), and the Progressive Party (PP). Costa testified that companies that win contract bids typically aim at making from 10 to 20 percent on top of costs (the so-called Budget Difference Income, or BDI) for every service rendered. However, winning bidders were also required to add an average of 3 percent as "political adjustment."⁶ He said that Petrobras' Department of Service, whose members were nominated by the PT, was responsible for managing and conducting the bids. Under the scheme, even lower ranking Petrobras employees were able to amass millions of dollars in corrupt money. In his Department of Supply, Costa revealed that out of the 3 percent that companies paid in bribes, 2 percent on average was paid to the PT and 1 percent to the PP. Of that one percent to the PP, 60 percent was paid to the party, 20 percent was used to pay costs, (for the falsification of documents and money transfers, for example), and the remaining 20 percent was split between Costa and the money changer, Alberto Youssef. Costa also testified that in the departments controlled by the PT, the party would keep the entire 3 percent for itself.⁷

The revelations made by engineering manager Pedro Barusco during his testimony were even more damaging to the PT. Barusco confessed to having overseen the payment of bribes in connection to ninety different Petrobras contracts during the Lula and Rousseff administrations, from 2003 to 2013. According to Barusco, the deals were made in meetings between him, former Petrobras director for the Department of Services Renato Duque, and PT national treasurer João Vaccari Neto. Barusco claimed that Vaccari Neto helped divert up to USD 200 million in money to the PT from Petrobras contracts. The money was used to help finance the party's 2010 campaign, in which Rousseff was elected.

As mentioned earlier, the suspects' statements have been consistent with one another, with the names of the main players involved in the scheme cited multiple times by different people. In the department headed by Renato Duque, who was nominated to his position by the PT, investigators said that corruption was so pervasive that they used eleven different money changers (or "doleiros") just to keep up with the cash flows diverted from the company. Barusco, in his confession, mentioned that he individually managed kickback payments for fourteen Petrobras contractors, but

denied that companies were harassed if they chose not to pay bribes.⁸ In his own words, corruption at Petrobras was “endemic and institutionalized.”⁹

As Brazil’s Federal Police and Public Ministry investigation has progressed, politicians’ names have continued to surface. Under Brazil’s constitution, however, politicians and sitting government officials can be tried only in the Supreme Federal Court (STF). That is why the judge responsible for the plea bargains and witness hearings, Sergio Moro, has prohibited defense lawyers and federal prosecutors from disclosing the names of politicians implicated during public hearings; such disclosures could jeopardize the prosecution. Lawyers representing the companies involved in the scandal have sought to move the hearings to a court in Rio de Janeiro, where Petrobras is headquartered, and thus remove Moro from the case. The Petrobras investigation, however, is extremely popular among Brazilians, with Moro even being elected “Brazilian of the Year” in 2014 by *IstoÉ*, a weekly newsmagazine. So far, any attempts to remove Moro from the Petrobras investigation have been promptly denounced by the local media.

A very serious attempt to disrupt Judge Moro’s investigation has nevertheless arisen from a different quarter. Last February, José Eduardo Cardozo, Brazil’s Minister of Justice, met with lawyers from UTC, Camargo Corrêa, and Odebrecht, three of the companies named in the corruption scandal. Cardozo instructed the lawyers not to allow their clients to enter plea bargains, “because the investigation would take a turn for the better after Carnival.”¹⁰ The reason behind Cardozo’s advice was the approval—given in record time by the Federal Accounting Union (TCU)—of a “Normative Instruction” drafted by Rousseff’s office that would directly affect the leniency agreements being negotiated with suspects in this case. The normative instruction protects plea bargains made with suspects by the Federal Comptroller’s Office (CGU) from nullification by the lower courts (i.e., Judge Moro).

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The President’s office appears to want to offer companies cited in the Petrobras case terms that are less punitive than those offered elsewhere, such as those offered by Moro. If this maneuver succeeds, accused companies will be required to pay fines for their participation in the Petrobras corruption scheme. However, they will no longer be prevented from bidding on

future public contracts, and suspects might not be forced to disclose all the information that they know in the case, such as the names of corrupt politicians.¹¹ According to David Fleischer, a University of Brasília professor emeritus and corruption expert, the TCU's approval of the new document is great news for Lula and Rousseff because it significantly reduces the likelihood of them being named by plea bargaining suspects. This will also insulate Rousseff from attempts to impeach her for "crimes of responsibility."¹² Among other posts, Rousseff has held the position of Minister of Energy (2003 to 2005), and president of Petrobras' Board of Directors, from 2005 until her first presidential election in 2011.

Other threats to the Lava Jato investigation have been more physical in nature, such as that experienced by Brazil's general prosecutor, Rodrigo Janot, the lead prosecution investigator. His house in Brasília, the country's capital, was broken into in January 2015, but out of the many valuable objects in the house, only the remote control for the front gate was taken. Lacking another explanation, the incident was perhaps an attempt to intimidate Janot. The prosecutor has now presented to the Supreme Federal Tribunal the names of all politicians involved in the Petrobras corruption scandal who had been revealed by Alberto Youssef, a black-market money dealer, and former Petrobras director Paulo Roberto Costa, in their plea bargain testimony. Security for Janot has increased significantly since then.¹³

"JUNK" VALUE AND THE CHANGE OF POST

The fall of Maria das Graças Silva Foster, former head of Petrobras, is in many ways a disappointing story in itself. A Petrobras career engineer, Foster was raised in one of the poorest and most violent neighborhoods in Rio de Janeiro, called "Complexo do Alemão," and paid for her studies in part by recycling trash. Foster managed to graduate from college with a degree in chemical engineering; she obtained a master's degree in nuclear engineering and later an MBA. She started working at Petrobras in 1981 and enjoyed the professional respect of many of her co-workers. Rousseff nominated Foster, a close friend, to head Petrobras. She was seen as a more technical choice for the company.

Despite Rousseff's initial public statements in support of Foster, the pressure to change Petrobras' leadership became insurmountable as details of its corrupt practices started piling up. When Foster and the other directors finally resigned, Rousseff had yet to select Foster's replacement. The corruption scandal has made it difficult to find a successor. On

February 6, two days after Foster's resignation, Rousseff named Aldemir Bendine, then president of Banco do Brasil, the country's largest state-controlled commercial bank, to replace her. The Brazilian stock market reacted negatively to Bendine's nomination because of his poor reputation for integrity. To illustrate, Bendine has yet to justify BRL 280,000 (USD 95,000) of assets shown in his tax returns, and he inappropriately intervened in a million-dollar loan application on behalf of a starlet socialite from São Paulo at the BNDES, Brazil's main development bank.¹⁶ On the day Bendine's nomination was announced, Petrobras' stocks fell by 6.34 percent on the Ibovpa, Brazil's largest stock exchange market.¹⁷ The Petrobras Administrative Council approved Bendine's nomination by a 7-3 vote. The dissenting votes were cast by two representatives of Petrobras' shareholders and the company's workers.¹⁸

THE SCOPE OF THE CORRUPTION ALLEGATIONS

In addition to paying bribes and money laundering, the companies cited in the Lava Jato investigation are also being accused of cartel practices. The accused include some of Brazil's largest construction companies. According to the plea-bargaining defendants, the companies would determine among themselves the winners of each bid, and how much each would charge Petrobras for the services rendered. Among the 25 companies accused in the investigation are: OAS, Odebrecht, Engevix, Queiroz Galvão, Iesa, Camargo Correa, UTC, Mendes Junior, Andrade Gutierrez, and Toyo Setel. The contracting companies also guided money changers on how to collect bribes overseas, and how to prevent them from being traced by law enforcement authorities. Some of the banks mentioned in the corruption scheme include HSBC, Royal Bank of Canada, Banque Cremer, Banque Pictet, and PBK.

As damaging as the Petrobras scandal already is to the reputation of Brazil's business sector, the Lava Jato investigation might be only the tip of a massive corruption iceberg. Details have surfaced during the investigation about corruption schemes involving other sectors of the economy. When law enforcement agents searched the office of the money changer Alberto Youssef, for example, they found a

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spreadsheet in which Youssef kept the records of 170 private companies in business with the government that were involved in some type of kickback scheme. These companies, in turn, were involved in 747 public infrastructure projects, estimated in BRL 11.5 billion (USD 4.5 billion). Fifty-nine percent of these projects were linked to Petrobras, but there were other sectors involved in kickback schemes as well, such as airports, irrigation, energy, mining, sanitation, and transportation. Many of these projects received preferential loans from the BNDES, Brazil's development bank, with construction taking place not only in Brazil, but also in Argentina, Cuba, Ecuador, and Uruguay. It seems that corruption is endemic and institutionalized, not only at Petrobras, but in Brazil as a whole.

INTERNATIONAL ASPECTS

The apparent amount of bribes, and the long period over which they were paid, have significant international implications. Among the multinationals connected to the scandal by former Petrobras executives are Rolls-Royce, SBM Offshore, Maersk, the Brazilian shipbuilding units of Keppel Corporation and Sembcorp Marine, three Brazilian shipbuilders

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with Japanese minority shareholders, including units of industrial groups Kawasaki and Mitsubishi, and the engineering companies IHI Corporation and JMU.¹⁹

Since many of these multinationals and Petrobras itself are on the New York Stock Exchange, and because some of the transactions made in the scandal used dollars to clear the transactions, the U.S. Departments of Justice (USDOJ) and the Securities and Exchange Commission will have jurisdiction.²⁰ Indeed, USDOJ has already exercised its jurisdiction in another Brazilian corruption case, when in 2007 the New York City prosecutor indicted Paulo Maluf, the former governor of São Paulo and now Congress member.²¹ Their determination of whether to start a criminal investigation may depend in part on whether they believe Brazilian prosecutors are adequately handling the prosecutions. Indeed, Siemens found itself entering into plea bargains and

criminal settlements with agencies across multiple jurisdictions, including the United States and Germany, for anti-corruption charges.²² An important issue will be whether the defendants facing prosecutions in multiple countries can successfully raise the double jeopardy argument. The United Kingdom and other countries have also proactively asserted extraterritorial jurisdiction for transnational bribery; some multinational corporations might face more than just two prosecutors. Another issue for foreign prosecutors will be whether the Brazilian government will be able to participate and obtain restitution for the funds lost due to the bribes.

A problem when foreign prosecutors prosecute transnational corruption cases is that, while the bulk of the cases end in pleas and large monetary penalties, the source country (e.g., Brazil) rarely receives much of the financial penalties that must be paid as part of the deferred prosecution agreements (often in the hundreds of millions of dollars), or evidence to prosecute the cases. A recent study showed that, of the 395 settlements that occurred between 1999 and mid-2012, a total of USD 6.9 billion in monetary sanctions was imposed.²³ Most of these monetary sanctions were imposed by countries where the corrupt companies (and related individual defendants) are headquartered or otherwise operate (mostly the United States and United Kingdom). Only about USD 197 million, or 3.3 percent of the funds, has been returned or ordered returned to the countries whose officials were bribed or allegedly bribed.²⁴ Source countries also have difficulty in obtaining evidence. Although they can try to obtain restitution judicially and administratively, the source countries have not had much success in transnational corruption cases.²⁵ Hence, the decision by foreign prosecutors to act on the Petrobras scandal may have important implications for Brazil, both in terms of accountability and protection of its scarce financial resources.

Another international consequence of the Petrobras investigation is that many countries, such as Canada, debar companies from selling to the government for up to ten years if they are convicted of crimes in other countries. At present, Hewlett-Packard, Inc., BAE Systems PLC, and Siemens AG are among the companies facing sanctions in Canada for crimes committed abroad.²⁶ Since most big engineering and construction companies that worked with Petrobras normally pursue Canadian government contracts, given the substantial size of the Canadian market, they could be barred from doing business in Canada if they are convicted of corruption in Brazil.

CONCLUSION

The Petrobras scandal demonstrates that Brazil and other countries with SOEs will need to substantially improve the transparency and accountability of their operations and of their boards' governance. SOEs in countries that fail to guarantee such business standards will often find themselves at risk for political mismanagement and abuse, as has occurred in Brazil. As signaled by Moody's recent downgrade of Petrobras' stock to junk status, the scandal has made it very hard for the company to close its budget balance. Not only has Petrobras lost up to 80 percent of its market value, but the company is also having great difficulty raising private capital to pay its debt commitments and to continue sponsoring its expansionary ambitions. As many analysts already have suggested, Petrobras' monstrous debt is most likely to be paid by the Brazilian taxpayers.

The company's minority shareholders have also been severely hurt by the financial assault that Brazilian politicians have inflicted on the oil giant. At the realization that they were investing in a fraudulent company, many groups in Brazil and in the United States filed collective action lawsuits against Petrobras and its executives. Among the claims made by lawyers representing these groups in the United States is the claim that the company violated rules established by the Securities and Exchange Commission (SEC), which regulates the stock market.²⁷

The Petrobras scandal also has wreaked havoc in the lives of numerous stakeholders within Brazil and abroad. Because the company decided to interrupt many of its operations indefinitely, thousands of workers have lost their jobs, supply companies have already filed for bankruptcy, and whole communities are now hopelessly indebted after making investments in infrastructure to host Petrobras-related operations sites. Empty schools, houses, hotels, and restaurants, many of which are owned by mom-and-pop businesses, are now experiencing the cascade effect of a political corruption debacle.²⁸

The scandal is also forcing banks and other companies that have business dealings with Brazilian SOEs to determine whether they themselves have had any corrupt transactions. If they detect evidence of suspicious transactions or circumstances (e.g., unaccounted-for or off-book payments), they should undertake an internal investigation to determine whether they may need to make a voluntary disclosure and take other steps to mitigate potential law enforcement and regulatory risks.²⁹

For many, the Petrobras corruption case has reignited the decades-long debate about the wisdom regarding the existence of SOEs and their capacity to remain insulated from political interference. The problem is

that changes in the quality of public institutions tend to lag countries' economic performance. In the last two decades or so, as emerging economies have become wealthier at a relatively faster rate (in great part due to trade), and as their economies have become more sophisticated and financially interconnected with the international system, check-and-balance mechanisms have been unable to keep up with the increasing opportunities for graft that prosperity brings. This is certainly a new challenge that citizens will need to consider when debating the role and size of the state that is best suited for their societies. However, regardless of the side on which one may fall in this debate, it is clear that governments, international organizations, and non-governmental organizations must continue to step up their actions to enhance national and international conventions, laws, and regulations concerning transparency, governance, and accountability. They should also take steps to develop anti-corruption regimes and networks. Such efforts may take generations to succeed, but they are worth pursuing. After all, while the Petrobras case represents the face of a predatory government, it simultaneously sheds a very positive, if surprising, light on the institutional capacity of Brazilian law enforcement authorities, who have been able to bring the Petrobras suspects to justice.^f

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ENDNOTES

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