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The next best thing

Brazil's heralded Clean Companies Act came into force just two months before the launch of Operation Car Wash, making it a largely ineffective tool in the country's mammoth corruption probe. What other options do the authorities have, ask partner Asheesh Goel and associates A Samad Pardesi and Charles Zagnoli of Ropes & Gray LLP

Brazilian authorities launched Operation Car Wash, the largest corruption investigation in the nation's history, just two months after Brazil's heralded Clean Companies Act took effect. Ironically, this landmark anti-corruption legislation may only play a small role in the investigation of corruption at Brazil's state-owned oil company; most of the misconduct alleged to this point predates the act, and Brazilian law bars the retroactive application of civil sanctions. Without the act, investigators must look to older, less potent anti-bribery laws to prosecute a scandal that has politically and economically destabilised a nation – all while the administration faces mounting pressure to end the country's endemic corruption. Prosecutors have sought to compensate for the Clean Companies Act's inapplicability, but the extent to which they will succeed remains unclear.

Operation Car Wash was launched in early 2014, when Brazilian authorities began investigating gas stations and laundromats they suspected of money laundering in southern Brazil. The investigation's scope has since expanded rapidly: instead of a regional money laundering ring, investigators have allegedly discovered a well-organised and long-running bribery scandal at Petrobras, a state-owned oil company and major player in the global energy industry. According to investigators, a large group of executives, suppliers, construction contractors and politicians rigged

Petrobras's procurement process so that preselected construction firms would win inflated contracts. Funds thus diverted became bribes for politicians or executives. The politicians in turn appointed favourable procurement personnel to Petrobras to keep the scheme running. In the shadows ran a cast of payment intermediaries who obscured the money trail. The scheme may have started as early as 2003, and it presumably ended when authorities made a wave of arrests in March 2014.

The investigation continues, but the fallout is already severe. To date, over 200 individuals have been investigated, over 100 have been arrested or indicted and approximately 80 have been convicted. The list of arrests includes numerous Petrobras executives, politicians, and executives from major Brazilian construction companies. Other notable figures remain under investigation, including former president Luís Inácio Lula da Silva, the treasurer of the ruling Workers Party, João Vaccari Neto, and the speaker of the Brazilian chamber of deputies, Eduardo Cunha. The scandal's effects have even reached beyond Brazil, implicating multiple foreign companies.

The economic consequences have been equally damaging. With annual revenue of approximately US\$130 billion as of 2013, Petrobras is the largest company in Brazil and among the largest in the Southern Hemisphere. But its stock price has dropped by

two-thirds in the past three years, and the company wrote off US\$17 billion in over-valued assets in 2015. Petrobras has also been forced to lay off significant portions of its workforce, divest US\$13.7 billion in assets over the coming years, and abandon a number of major development projects. The low price of oil may further worsen the company's prospects.

An economic recession partly resulting from Petrobras's struggles, and other high-profile investigations (such as the so-called Operation Zealots, which alleges that companies bribed administrative judges in the tax authority to secure favourable decisions), have prompted Brazilians to increasingly voice their discontent, including through large-scale protests. President Rousseff and her Workers Party are the main subjects of these protests. The president campaigned on a promise to grow the economy and combat corruption. Instead, she finds herself presiding over a sliding economy and a corruption scandal that has overrun the country's largest company and the president's former employer, and implicated senior officials within her own party. Her approval rating has sunk in recent months, and an overwhelming 70 per cent of Brazilians believe she is at fault for the scandal. Brazilians have even demanded her impeachment.

In response, President Rousseff has reaffirmed her commitment to fighting corruption, pledging support to Operation Car Wash and other ongoing investigations.

Prosecutors and lawmakers have also responded. Authorities have launched an aggressive anti-corruption campaign that includes several large-scale investigations and a number of high-profile arrests. Lawmakers have supported this campaign with a battery of new anti-corruption laws, most prominent among them the Clean Companies Act, enacted just before the scandal was exposed.

Brazilian anti-corruption law

The Clean Companies Act took effect on 29 January 2014, a mere two months before Operation Car Wash began. The act holds companies doing business in Brazil strictly liable for their representatives' and agents' corrupt misdeeds – punishing not only companies that bribe but also those that commit procurement fraud, finance illegal acts, use intermediaries to disguise illegal acts and obstruct investigations. An offender faces fines of up to 20 per cent of its gross revenue in the prior fiscal year, or up to 60 million reais (US\$16 million) if revenues are difficult to calculate. Liable defendants must publish the decision in several outlets, including on the company's website. Defendants also may be required to disgorge their ill-gained profits, suspend operations or even dissolve if the company has repeatedly been used to facilitate illegal acts. And the government may debar a defendant from public funding programmes and from borrowing from public financial institutions for up to five years.

A company can mitigate and even avoid some of these penalties if it cooperates with investigators and takes steps to prevent future misconduct. The act authorises prosecutors to sign leniency agreements that reduce fines by up to two-thirds and exempt defendants from the publication requirement and threat of debarment. But

to qualify for a leniency agreement, a company must cease its misconduct, admit to the violations and voluntarily cooperate with the investigation. Cooperation has other benefits: a company that self-discloses violations could reduce its fine by up to two percentage points, and one that cooperates with investigators could reduce its fine by up to one-and-a-half points. Similarly, an effective anti-corruption compliance programme could reduce a fine by as much as four percentage points.

These new enforcement tools will positively affect Brazil in coming years, but they will likely play a small role in Operation Car Wash: the corruption scheme alleged by the investigation largely predates the Clean Companies Act's January 2014 effective date, and Brazilian law prohibits the retroactive application of civil sanctions. Thus, prosecutors are likely to be able to charge only a small number of defendants under the Clean Companies Act – and only for a small piece of the scheme.

Instead, prosecutors will have to rely principally on Brazil's older anti-corruption laws, but only two of these laws apply to corporations, and both have their limitations. The 1993 Public Procurement Law punishes certain misconduct in public tenders, but the act defines the most serious misconduct only as criminal offences, for which companies generally bear no liability under

Brazilian law. The 1992 Administrative Misconduct Law punishes any person who induces, assists in, or benefits from a public official's corruption, and it carries penalties comparable to those of the act. But the law also requires prosecutors to present more difficult cases: prosecutors must prove the public official's violation to make their case against a private defendant, and they must show the company acted wilfully and intentionally. Moreover, neither law expressly

authorises prosecutors to negotiate leniency agreements, casting doubt on their authority to do so in a pre-Clean Companies Act world. And companies have little incentive to cooperate or to voluntarily overhaul internal controls when they can expect no benefit in return. These older laws thus offer more limited tools than the act.

A pressing mandate, a lagging legal regime

Prosecutors' inability to fully utilise the Clean Companies Act in Operation Car Wash puts them in a difficult position. The public has issued a strong mandate to end corruption in Brazilian business and government, but the law has been somewhat slow to respond. Now, the Clean Companies Act's sideline role in Operation Car Wash weakens prosecutors' ability to threaten meaningful corporate liability and to promise leniency. This limits the investigation's effectiveness in two important ways.

First, companies have less reason to cooperate with the government's investigation by, for instance, giving authorities access to files and personnel, identifying individual wrongdoers and sharing information from the companies' own investigations. Such cooperation makes the government's work more efficient and effective. It can also quickly expand an investigation beyond domestic borders,

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to overseas offices or even foreign distributors or agents. Without a company's help, diplomatic hurdles or jurisdictional limitations may put overseas information beyond prosecutors' reach. But companies have little reason to voluntarily cooperate when they face no meaningful threat of liability and a dubious prospect of leniency.

Second, prosecutors lose leverage they could use to push for changes in compliance programmes. Effective programmes often prevent corruption before it starts, and they greatly increase the chance that a company will detect corruption should it occur. The programmes can also change company cultures by sensitising employees to the importance of ethical business practices. When these changes are aggregated across an economy, the effects can be significant. But the effects are difficult to create when prosecutors can only indict individual employees, without any means of pushing for systemic changes across the business. From this position, prosecutors can treat the symptoms but not the disease.

Prosecutors involved in Operation Car Wash have sought to compensate for these limitations. Notably, Brazilian authorities have extensively cooperated with prosecutors in countries such as the United Kingdom and the United States. These countries' laws were in force during much or all of the Petrobras scheme and may cover some multinational companies at the scandal's centre. To the extent foreign prosecutors can bring charges or negotiate settlements that Brazil's cannot, the limited role of the Clean Companies Act may not be as keenly felt. In a similar vein, domestic prosecutors have found creative ways to aid each other; for example, some leniency agreements negotiated by Brazil's antitrust authority under Law No. 12,529/11 arguably helped to develop facts in Operation Car Wash.

Brazilian authorities have also tried to maximise the act's effect by threatening companies with charges based on the act even when the charges would retroactively apply the act. Observers doubt that courts would support this position, and authorities may privately agree: when a would-be defendant refuses to negotiate in the face of such threats, prosecutors generally file charges under the Administrative Misconduct Law instead. But authorities are nonetheless trying to press as many companies as possible to negotiate leniency agreements. It is unclear, however, whether prosecutors have the power to negotiate agreements in cases outside the act. The government has passed a provisional measure authorising the agreements in Operation Car Wash, but the measure is controversial, leaving its future uncertain. Critics note that it retroactively applies Clean Companies Act provisions that benefit defendants while leaving dormant those provisions that would punish them.

This focus on the legal tools prosecutors lack should not detract from their accomplishments to date. Operation Car Wash has resulted in charges against numerous individuals, sparked parallel investigations in other countries, and brought a massive corruption ring to light. But the late timing of the act's passage raises the question of whether the investigation will ultimately prove a missed opportunity. Prosecutors have found ways to answer the public mandate despite the lagging legal regime, but the challenges they face without the act are considerable. Time will tell whether this unprecedented investigation will ultimately change the business and government culture. Such a movement has already begun in Brazil, but much work remains to be done.