



# Decision to exclude Centrais Elétricas Brasileiras S.A. (Eletrobras) December 2016

## Summary

KLP and the KLP Funds (hereafter, "KLP") have decided to exclude the company Centrais Elétricas Brasileiras S.A. (hereafter, "Eletrobras") from their investments due to an unacceptable risk of gross corruption.

Eletrobras is the largest electric utility in Latin America.<sup>1</sup> The company is based in Brazil and is listed in Sao Paulo, New York (NYSE) and Madrid.<sup>2</sup> The Brazilian government is the majority shareholder.<sup>3</sup> Eletrobras holds a dominant position in the Brazilian market, and began expanding internationally in 2008 to Nicaragua, Uruguay, and Argentina.<sup>4</sup> In conjunction with its analysis of Petrobras, KLP discovered information suggesting Eletrobras also faced a high risk of corruption, although the case has not garnered nearly the amount of media attention as the Lava Jato investigation surrounding Petrobras.

In May 2016, the NYSE suspended trading of Eletrobras shares after the company announced that it would not make the deadline to submit its financial results for 2014.<sup>5</sup> The delay resulted from ongoing negotiations with the US Securities and Exchange Commission (SEC) to estimate the cost of corruption.<sup>6</sup> In August 2016, the former CEO of Eletrobras subsidiary Eletronuclear was sentenced to 43 years in prison for paying bribes to suppliers in connection with the construction of a nuclear power plant in Brazil.<sup>7</sup> At the time that KLP

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<sup>1</sup> Eletrobras, *About Us*. URL: <http://www.eletrobras.com/elb/main.asp?Team={5509CA89-1D49-44C9-905C-9B159FFC4935}>.

<sup>2</sup> Ibid.

<sup>3</sup> Ibid.

<sup>4</sup> Eletrobras, *Eletrobras in the World*. URL: <http://www.eletrobras.com/elb/main.asp?View=%7B6C415599-C212-44B7-BC88-6A52C44E0DAA%7D&Team=&params=itemID=&UIPartUID=%7BD90F22DB-05D4-4644-A8F2-FAD4803C8898%7D>.

<sup>5</sup> Dezem, Vanessa, "Brazil utility suspended on NYSE as costs of corruption unclear", *Bloomberg* (18 May 2016). URL: <http://www.bloomberg.com/news/articles/2016-05-17/eletrobras-sees-u-s-delisting-on-deadline-miss-amid-graft-probe>.

<sup>6</sup> Ibid.

<sup>7</sup> Ewing, Reese, "Brazil Eletronuclear CEO gets 43-year sentence for corruption", *Reuters* (4 August 2016). URL: <http://www.reuters.com/article/brazil-corruption-eletrobras-idUSL1N1AL16E> (last visited 9 August 2016).

decided to exclude the company, Eletrobras had not yet submitted its US financial statements for 2014 or for 2015.<sup>8</sup>

Shortly before publication of this decision, Eletrobras reached out to KLP to clarify that the company filed its 20-F form with US authorities, including audited financial statements for 2014 and 2015.<sup>9</sup> Eletrobras confirms that it uncovered bribery and bid-rigging in supplier contracts, dating back to 2008. In its submissions to the SEC, the company writes:

*The Independent Investigation reports determined overpricing related to bribery and bid-rigging (a form of fraud in which a commercial contract is promised to one party even though for the sake of appearance several other parties also present a bid. This practice is illegal in most countries) activities deemed to be of an illicit nature in some contracts, since 2008, with certain contractors and suppliers of the affected projects. The range of bribery estimated impacts is from 1% to 6% of the contract price and certain other fixed amounts, and the bid-rigging estimated impact is 10% of payments related to one specific contract (R\$ 16 million).<sup>10</sup>*

The company outlines a comprehensive compliance program it is in the process of developing, but cautions that the program may not be fully implemented before 2018.<sup>11</sup> KLP commends the company for improving its compliance system and implementing additional training activities. Nevertheless, KLP remains deeply concerned that Eletrobras continues to maintain that it is a victim of corruption, despite evidence of bribery and bid-rigging over a period of seven years, as well as the involvement of former senior leaders in the company and its subsidiaries. Additionally, the compliance measures Eletrobras has announced appear to be still in their infancy, and the company is clear that full implementation may not be complete before early 2018.<sup>12</sup> As a result, it is not yet possible to conclude whether the compliance program will be sufficient to prevent corruption in the near term.

For all of the above reasons, KLP has determined the risk of future corruption to be unacceptably high and has therefore decided to exclude Eletrobras from KLP and the KLP funds' investments.

## 1. Case description and the company's involvement

According to news reports, the Eletrobras internal investigation revealed evidence of bribes paid to suppliers in connection with the construction of up to nine projects.<sup>13</sup> The suppliers

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<sup>8</sup> Dezem, Vanessa, "The one Brazilian scandal almost no one is talking about", *Bloomberg* (22 December 2015). URL: <http://www.bloomberg.com/news/articles/2015-12-22/in-petrobras-s-shadow-one-company-races-to-contain-graft-probe>.

<sup>9</sup> Notes on file with KLP.

<sup>10</sup> Eletrobras Form 20-F (2015), p. 1. URL: <http://ri.eletrobras.com/en/ri/DemonstracoesFinaceiras/20-F%202015.PDF>.

<sup>11</sup> *Ibid.*, p. 21.

<sup>12</sup> *Ibid.*, p. 1.

<sup>13</sup> Stauffer, Caroline, "Internal investigation of Brazil's Eletrobras expands", *Reuters* (7 January 2016). URL: <http://www.reuters.com/article/brazil-corruption-eletrobras-idUSL1N13W21720160107>.

included those already implicated in the "Lava Jato" investigation, who were alleged to have operated the same scheme with Eletrobras.<sup>14</sup>

In March 2015, the CEO of a construction company involved in the Petrobras scandal testified to bribe payments in connection with the construction of the Angra III nuclear power plant and Belo Monte hydropower dam for Eletrobras.<sup>15</sup> The Belo Monte dam has also received criticism for a range of environmental and indigenous rights issues, but that case falls outside the scope of this decision.

Another construction company executive also testified to the payment of bribes in connection with Angra III.<sup>16</sup> In July 2015, Brazilian authorities arrested the former CEO of Eletronuclear, the Eletrobras subsidiary that operated the Angra III plant.<sup>17</sup>

Eletrobras auditor KPMG refused to sign off on the company's 2014 and 2015 US financial statements.<sup>18</sup> As a result, the NYSE suspended trading of Eletrobras shares in May 2016 and announced a plan to delist the company.<sup>19</sup> The NYSE delisting hearing was set for October 13, 2016.<sup>20</sup> As of September 2016, KPMG had still not approved the 2014 Eletrobras financial statements.

In August 2016, former Eletronuclear CEO Othon Luiz Pinheiro da Silva was sentenced to 43 years in prison for corruption, money laundering, organized crime, and obstruction of justice.<sup>21</sup> The conviction related to his involvement in a kickback scheme with suppliers for the Angra III

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<sup>14</sup> Ibid. See also, Stauffer, Caroline, "Eletrobras' corruption probe zeroes in on Brazilian dams", *Reuters* (7 October 2015). URL: <http://www.reuters.com/article/brazil-eletrobras-idUSL1N1182SY20151007> (last visited 9 August 2016) ("Brazilian federal prosecutors say construction firms involved in Brazil's largest-ever corruption scandal at state oil company Petrobras likely repeated a price fixing and political kickback scheme at Eletrobras, a smaller state-run firm that employs some of the same contractors as the oil giant.").

<sup>15</sup> Dezem, Vanessa, "The one Brazilian scandal almost no one is talking about", *Bloomberg* (22 December 2015). URL: <http://www.bloomberg.com/news/articles/2015-12-22/in-petrobras-s-shadow-one-company-races-to-contain-graft-probe>.

<sup>16</sup> Ibid.

<sup>17</sup> Ibid.

<sup>18</sup> Dezem, Vanessa, "The one Brazilian scandal almost no one is talking about", *Bloomberg* (22 December 2015). URL: <http://www.bloomberg.com/news/articles/2015-12-22/in-petrobras-s-shadow-one-company-races-to-contain-graft-probe> (last visited 9 August 2016) ("Until Eletrobras can put a price tag on the cost of possible corruption at the company, its auditor, KPMG LLP, is refusing to sign off on its 2014 financial report...")

<sup>19</sup> Ibid.

<sup>20</sup> Parra-Bernal, Guillermo, "Brazil's Eletrobras says NYSE set October hearing on delisting plan", *Reuters* (15 June 2016). URL: <http://www.reuters.com/article/us-eletrobras-delisting-nyse-idUSKCN0Z12O6> (last visited 9 August 2016).

<sup>21</sup> Ewing, Reese, "Brazil Eletronuclear CEO gets 43-year sentence for corruption", *Reuters* (4 August 2016). URL: <http://www.reuters.com/article/brazil-corruption-eletrobras-idUSL1N1AL16E> (last visited 9 August 2016).

nuclear reactor,<sup>22</sup> involving the payment of bribes estimated at over USD 60 million.<sup>23</sup> The USD 15,3 billion Angra III nuclear reactor has been under construction for over thirty years, with substantial delays and cost overruns of over USD 5 billion.<sup>24</sup>

## Company response

In June 2015, within a few weeks of the construction executives' testimony about bribery involving company projects, Eletrobras reported to the SEC that the company had hired US law firm Hogan Lovells to investigate potential violations of the US Foreign Corrupt Practices Act (FCPA). Eletrobras announced that the investigation would focus on the company's "business relationship with construction companies mentioned in the investigation context of the operation called 'Lava Jato'."

In July 2016, the then-CEO of Eletrobras subsidiary Eletronuclear was forced to resign "by court order... for allegedly interfering in an internal investigation to help Pinheiro"<sup>25</sup> (the recently-sentenced former Eletronuclear CEO). On July 15, Eletrobras announced it had hired a new chief compliance and risk management officer.<sup>26</sup> The company issued a press release on July 25, stating that the Eletrobras CEO, chief generation and distribution officer, chief transmission officer, chief financial and investor relations officer, and chief administration officer had all been replaced.<sup>27</sup>

Upon the sentencing of Mr. Pinheiro, Eletrobras issued a press release noting that the external investigation through US law firm Hogan Lovells was ongoing.<sup>28</sup>

## Company dialogue

In dialogue in January 2016, Eletrobras explained that it adopted a new compliance program in December 2014.<sup>29</sup> This was approximately two months after the Operation Lava Jato

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<sup>22</sup> Ibid.

<sup>23</sup> Blount, Jeb, "Brazil police arrest 19 in Eletrobras nuke-plant bribe probe", *Reuters* (6 July 2016). URL: <http://www.reuters.com/article/us-brazil-corruption-idUSKCN0ZM13N>

<sup>24</sup> Ibid.

<sup>25</sup> Ibid.

<sup>26</sup> Centrais Eletricas Brasileiras S/A, "Market announcement – compliance and risk management". URL: <http://www.eletrobras.com/elb/ri/main.asp?Team={16CF4A82-16BC-4D94-A887-6218834F4480}> (last visited 10 August 2016).

<sup>27</sup> Centrais Eletricas Brasileiras S/A, "Market announcement – new managers" (25 July 2016). URL: <http://www.eletrobras.com/elb/ri/main.asp?Team={16CF4A82-16BC-4D94-A887-6218834F4480}> (last visited 10 August 2016).

<sup>28</sup> Centrais Eletricas Brasileiras S/A, "Market announcement – Eletronuclear's former CEO imprisonment" (4 August 2016). URL: <http://www.eletrobras.com/elb/ri/main.asp?Team={16CF4A82-16BC-4D94-A887-6218834F4480}> (last visited 10 August 2016).

<sup>29</sup> Notes on file with KLP.

investigation first revealed the bribery scheme involving Petrobras. It also followed the adoption of more stringent Brazilian anti-corruption regulation earlier in the year.

In January 2016, Eletrobras confirmed that it does not follow up existing suppliers related to compliance.<sup>30</sup> Eletrobras explained that this has not been a concern, as the penalties for corruption under Brazilian law, including barring companies from public tenders and contract cancellation, provide an effective deterrent.<sup>31</sup> Eletrobras provided KLP with examples of an anti-corruption clause used in supplier contracts.<sup>32</sup> KLP requested an estimate of the approximate percentage of current outstanding supplier contacts that include this clause, but the company was unable to provide this information.<sup>33</sup>

In February 2016, Eletrobras announced the creation of a new position: Executive Officer of Governance, Risk Management and Compliance.<sup>34</sup>

KLP arranged to join a call with Eletrobras on 3 May 2016.<sup>35</sup> The company cancelled the call a few days in advance, and on 6 May, announced it was in dialogue with the SEC.<sup>36</sup> The negotiations concerned "the procedures that have been adopted by the Company, including the internal investigation conducted by Hogan Lovells (the 'Investigation'), the substantial completion of which is a requirement to file Eletrobras' annual reports on Form 20-F for the years ended December 31, 2014 and 2015...."<sup>37</sup>

On May 11, 2016, Eletrobras added that the company needed to reach agreement with the SEC on the 20-F filing to avoid delisting from the NYSE.<sup>38</sup> Six days later, Eletrobras reported that it would miss the SEC deadline "as the independent internal investigation connected by Hogan Lovells US LLP is still not substantially complete."<sup>39</sup> On the same day, the NYSE suspended trading in Eletrobras shares.

KLP rescheduled the call with Eletrobras for September 2016. Representatives for the company underlined that Eletrobras sees itself as a victim of corruption by the individual

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<sup>30</sup> Ibid.

<sup>31</sup> Ibid.

<sup>32</sup> Ibid.

<sup>33</sup> Ibid.

<sup>34</sup> Centrais Eletricas Brasileiras S/A, "Market announcement 02242016 – Executive officer of governance, risk management and compliance" (24 February 2016). URL: <http://www.eletrobras.com/elb/ri/main.asp?View={B0D01098-4F66-4619-A6EE-599173D33BB8}> (last visited 11 August 2016).

<sup>35</sup> Correspondence on file at KLP.

<sup>36</sup> Centrais Eletricas Brasileiras S/A, "Market announcement 20-F" (6 May 2016). URL: <http://www.eletrobras.com/elb/ri/main.asp?View={B0D01098-4F66-4619-A6EE-599173D33BB8}>.

<sup>37</sup> Ibid.

<sup>38</sup> Centrais Eletricas Brasileiras S/A, "Market announcement – relevant fact 20 F 11 05 2016" (11 May 2016). URL: <http://www.eletrobras.com/elb/ri/main.asp?View={B0D01098-4F66-4619-A6EE-599173D33BB8}>.

<sup>39</sup> Centrais Eletricas Brasileiras S/A, "Market announcement – relevant fact 20 F 17 05" (17 May 2016). URL: <http://www.eletrobras.com/elb/ri/main.asp?View={B0D01098-4F66-4619-A6EE-599173D33BB8}>.

company executives under investigation or convicted. KLP pointed out that the US law firm has a mandate to investigate potential violations of the US Foreign Corrupt Practices Act, which involves *corporate* violations, not simply those of individuals. Eletrobras responded that the results of the Hogan Lovells investigation were not yet available, although they believed a final report would be available by the end of October. The company planned to publish the main findings and the measures Eletrobras has adopted. Eletrobras confirmed that the NYSE delisting hearing will be held in October, but stated that the Hogan Lovells report is not connected to this process.

Eletrobras uses suppliers that have been implicated in the Lava Jato investigation. The company is in the process of looking into their legal options for cancelling or suspending contracts with certain suppliers.<sup>40</sup> Currently, Eletrobras' understanding is that they cannot cancel contracts unless the suppliers are convicted.<sup>41</sup>

The Eletrobras board of directors approved the company's current compliance program in mid-2014.<sup>42</sup> As of June 2016, the new compliance program was not yet fully implemented.<sup>43</sup> Additionally, Eletrobras acknowledged in the same June 2016 SEC filing that:

*As a result of the management's evaluation of the effectiveness of information disclosure, controls and procedures of Eletrobras in 2015, the management determined that these controls and procedures were not effective due to material weaknesses in the internal controls over financial reports.*<sup>44</sup>

According to Eletrobras, the company's structure and lack of control over subsidiaries and joint ventures open the company to the risk that its employees or affiliates are involved in fraud, corruption, or bribery, and that its existing controls may not be effective:

*This risk is heightened by the fact that Eletrobras conducts many of its operations through SPEs<sup>45</sup> or consortia over which it has no control, has a large number of complex and valuable contracts with local and foreign suppliers, in addition to the geographic distribution of its operations and to the wide variety of parties involved in its business.*<sup>46</sup>

Eletrobras highlights its compliance program through a weekly videoconference. Additionally, all Eletrobras employees will have completed new e-learning program on anti-corruption and ethics by the end of December 2016.

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<sup>40</sup> Call with Eletrobras (2 September 2016), notes on file with KLP.

<sup>41</sup> Ibid.

<sup>42</sup> Securities and Exchange Commission Form 6-K, *Centrais Elétricas Brasileiras S.A. – Eletrobras*, June 2016, p. 18.

<sup>43</sup> Ibid.

<sup>44</sup> Ibid, p. 16.

<sup>45</sup> "Special purpose entities."

<sup>46</sup> Ibid., p. 15.

In November 2016, following publication of the company's 20-F with US authorities, Eletrobras noted that the company no longer faces delisting from the NYSE.<sup>47</sup> Eletrobras states:

*Since the start of the investigation, the Company replaced its entire Board of Directors, hired a new CEO and a Compliance Officer, and created an independent Compliance Department to help coordinate compliance across subsidiaries. The Risk Management and Compliance Officer and her team oversee implementation of the new compliance program and liaise on a weekly basis with compliance managers at each subsidiary.*<sup>48</sup>

According to the 20-F, Eletrobras has been cooperating with US authorities. Although the company has not received notification that it is under investigation for any FCPA violations, it cannot exclude the possibility of an investigation.<sup>49</sup> In July 2016, Brazilian prosecutors charged former company officers with "corruption, money laundering and obstruction of justice."<sup>50</sup> The company is cooperating in the investigation and writes that it intend "to pursue civil remedies against these defendants."<sup>51</sup>

The 20-F confirms that Eletrobras is in the process of addressing a number of compliance deficiencies uncovered through the internal investigation. These include structuring and developing its anti-corruption compliance policies for third parties – both for supplier contracts as well as shareholder agreements for special purpose entities (SPEs) in which Eletrobras is a shareholder. Eletrobras writes that in order to address material weaknesses in the company's internal financial controls, the company has developed the "Eletrobras 5 Dimensional Corporate Integrity Program", which consists of five action steps:

1. *Development of Company Culture;*
2. *Periodic Risk Assessment;*
3. *Policies and Procedures;*
4. *Communication and Training;*
5. *Continuous monitoring, repair and application of sanctions.*<sup>52</sup>

Eletrobras clarified that the weekly videoconference described earlier to KLP is an example of an initiative under the culture pillar, and cited the company's new e-learning program, to be released December 9<sup>th</sup>, as an example of "Communication and Training."<sup>53</sup>

Nevertheless, Eletrobras notes that a full overhaul of its compliance program may not be complete before "early 2018".<sup>54</sup> Lastly, Eletrobras cautions that it cannot rule out potential

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<sup>47</sup> Notes on file with KLP.

<sup>48</sup> Eletrobras Form 20-F (2015), p. 1. URL: <http://ri.eletrobras.com/en/ri/DemonstracoesFinaceiras/20-F%202015.PDF>.

<sup>49</sup> Ibid., p. 20-21.

<sup>50</sup> Ibid., p. 1.

<sup>51</sup> Ibid.

<sup>52</sup> Ibid.

<sup>53</sup> Ibid.

<sup>54</sup> Eletrobras Form 20-F (2015), p. 21. URL: <http://ri.eletrobras.com/en/ri/DemonstracoesFinaceiras/20-F%202015.PDF>.

sanctions due to the amount of time needed to establish a fully functioning compliance program:

*Due to the length of time required to fully implement our compliance program, we may be subject to sanctions and penalties related to the enforcement of the FCPA and the Brazilian Anti-Corruption Law.<sup>55</sup>*

Elctrobras is therefore clear that its updated compliance program may not be fully implemented before early 2018 and that the company may face penalties as a result.

## Analysis

According to the KLP Guidelines for Responsible Investment, "KLP shall exclude companies from investment where there is an unacceptable risk that the company is responsible for or complicit in...gross corruption...."<sup>56</sup>

### A. Gross Corruption

As noted in the decision to exclude Petrobras,<sup>57</sup> the definition of gross corruption provides:<sup>58</sup>

*Gross corruption exists if a company, through its representatives,*

*a) gives or offers an advantage – or attempts to do so – in order to unduly influence:*

*i) a public official in the performance of public duties or in decisions that may confer an advantage on the company; or*

*ii) a person in the private sector who makes decisions or exerts influence over decisions that may confer an advantage on the company,*

*and*

*b) the corrupt practices as mentioned under letter a) are carried out in a systematic or*

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<sup>55</sup> Ibid.

<sup>56</sup> KLP, *The KLP Guidelines for Responsible Investment* (last updated November 4th, 2014). URL: [http://english.klp.no/polopoly\\_fs/1.33317.1459346158!/menu/standard/file/KLP%20guidelines%20-For%20responsible%20investment%20-.pdf](http://english.klp.no/polopoly_fs/1.33317.1459346158!/menu/standard/file/KLP%20guidelines%20-For%20responsible%20investment%20-.pdf).

<sup>57</sup> KLP, "Decision to exclude Petróleo Brasileiro S.A. (Petrobras)" (1 June 2016). URL: [http://english.klp.no/polopoly\\_fs/1.34190.1466493152!/menu/standard/file/Petrobras%20decision%20to%20exclude.pdf](http://english.klp.no/polopoly_fs/1.34190.1466493152!/menu/standard/file/Petrobras%20decision%20to%20exclude.pdf).

<sup>58</sup> Council on Ethics, *Recommendation of 15 November 2007*, p. 4. URL: [https://www.regjeringen.no/globalassets/upload/fin/statens-pensionsfond/recommendation\\_on\\_siemens.pdf](https://www.regjeringen.no/globalassets/upload/fin/statens-pensionsfond/recommendation_on_siemens.pdf).



*extensive way.*<sup>59</sup>

In relation to the above definition, there is little in the case of Eletrobras that distinguishes that corruption scandal from the Operation "Lava Jato" revelations involving Petrobras. Both cases involved senior executives – including, in the case of Eletrobras, the CEO of a company subsidiary – convicted for "corruption, money laundering, organized crime and obstruction of justice."<sup>60</sup> Othon Luiz Pinheiro da Silva collaborated with Eletronuclear suppliers to overbill contracts for construction of a nuclear reactor and used the proceeds to bribe public officials.<sup>61</sup> Pinheiro da Silva was previously both the CEO of Eletronuclear and "a vice-admiral in the Brazilian navy."<sup>62</sup>

In relation to the second element of the "gross corruption" definition, the practices at issue occurred over a period of at least seven years and involved multiple contracts and third parties, as well as senior managers in Eletrobras and its subsidiaries. Therefore, the practices can be considered systematic.

## B. Forward-Looking Assessment

KLP also assesses the forward-looking risk that a portfolio company will be responsible for gross corruption in the future. In this respect, there are several factors that give KLP cause for concern.

Eletrobras' auditor's reluctance to approve the company's financial statements for 2014 and 2015 was in itself a strong indication that Eletrobras had not yet taken a full accounting of past misdeeds and addressed associated weaknesses systematic and comprehensive way. Due to the failure to submit these filings, as of September 2016, when KLP decided to exclude Eletrobras, the company faced delisting from the New York Stock Exchange. This was also a highly unusual situation – not to mention the conviction and sentencing of the former Eletronuclear CEO to 43 years in prison.

At the time KLP evaluated this case, Eletrobras still had not submitted its 20-F for 2014 and 2015, reinforcing our concerns that the company had not yet taken a full accounting of the extent and duration of the kickback scheme under investigation. It was therefore not possible at that time for KLP to assess whether the newly implemented measures were sufficient to address the risk Eletrobras faces of engaging in similar activities in the future.

In October 2016, Eletrobras filed its 20-F for 2014 and 2015, confirming that the company found evidence of "overpricing related to bribery and bid-rigging" dating back to as early as

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<sup>59</sup> Ibid, p. 3-4.

<sup>60</sup> Ewing, Reese, "Brazil Eletronuclear CEO gets 43-year sentence for corruption", *Reuters* (4 August 2016). URL: <http://www.reuters.com/article/brazil-corruption-eletrobras-idUSL1N1AL16E> (last visited 9 August 2016).

<sup>61</sup> Ibid.

<sup>62</sup> Ibid.

2008.<sup>63</sup> Thus, the violations have occurred over a period of at least seven years. Moreover, a quick check of the company's 20-F forms for the years 2009 to 2015 revealed that material weaknesses in Eletrobras' internal financial controls were identified in each of these seven years as well.<sup>64</sup> It is not possible to say whether remedying the identified deficiencies would have uncovered corruption at an earlier date. At a minimum, however, it raises doubts about Eletrobras' ability and/or willingness to improve its financial controls in a timely manner.

KLP commends the company for improving its compliance system and implementing additional training activities, but remains concerned about Eletrobras' admission that the measures may not be fully implemented before early 2018. Moreover, several supplier executives who have done business with both Petrobras and Eletrobras are in the process of entering plea agreements with Brazilian authorities, such that more information may be forthcoming. Eletrobras has published some preliminary conclusions from its internal investigation in the company's 20-F. It has not published the report itself, however, and has not declared whether it intends to do so. The internal investigation's finding related to possible violations of the US FCPA investigation have not yet been released either.

Given the information asymmetries highlighted above as well as multiple red flags, KLP remains concerned that Eletrobras maintains that it is a victim of corruption. Furthermore, the predicted delays in implementing a comprehensive compliance program indicate that the risk of corruption remains unacceptably high. As a result, Eletrobras' submission of its 20-F for 2014 and 2015 is not sufficient to warrant that KLP revisit its conclusion. On the contrary, the filings underscore KLP's initial concerns and illustrate the challenges that the company faces in developing and implementing an effective compliance program. Eletrobras has not yet overcome that challenge.

## Recommendation

For all of the above reasons, KLP Kapitalforvaltning recommends that KLP and the KLP mutual funds exclude Eletrobras from their investments at the latest 1 December 2016.

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<sup>63</sup> Eletrobras Form 20-F (2015), p. 21. URL: <http://ri.eletrabras.com/en/ri/DemonstracoesFinaceiras/20-F%202015.PDF>, p. 1.

<sup>64</sup> Eletrobras, *All Financial Statements, Form 20F*, <http://ri.eletrabras.com/en/ri/Paginas/Demonstracoes-Financeiras.aspx>.