

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 78824 / September 13, 2016**

**ACCOUNTING AND AUDITING ENFORCEMENT**  
**Release No. 3799 / September 13, 2016**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-17534**

**In the Matter of**

**PORTUGAL TELECOM,  
SGPS, S.A., now known as  
PHAROL SGPS, S.A.**

**Respondent.**

**ORDER INSTITUTING CEASE-AND-  
DESIST PROCEEDINGS PURSUANT TO  
SECTION 21C OF THE SECURITIES  
EXCHANGE ACT OF 1934, MAKING  
FINDINGS, AND IMPOSING A CEASE-  
AND-DESIST ORDER**

**I.**

The Securities and Exchange Commission (“Commission”) deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 (“Exchange Act”), against Portugal Telecom, SGPS, S.A., now known as Pharol SGPS, S.A. (“Portugal Telecom” or “Respondent”).

**II.**

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order (“Order”), as set forth below.

**III.**

On the basis of this Order and Respondent’s Offer, the Commission finds that:

## Summary

1. This financial reporting matter arises out of Portugal Telecom, SGPS, S.A.'s ("Portugal Telecom") misleading and inaccurate disclosures regarding its investments in debt instruments issued by entities of Portuguese conglomerate, Grupo Espirito Santo ("GES"). Banco Espirito Santo, S.A. ("BES"), one of Portugal Telecom's largest shareholders, was part of GES. Portugal Telecom invested in debt instruments issued by Espirito Santo International, S.A. ("ESI"), a GES entity. After these ESI debt instruments matured in February 2014, Portugal Telecom invested €897 million in commercial paper issued by Rio Forte Investments, S.A. ("Rio Forte"), another GES entity.

2. Portugal Telecom included this Rio Forte commercial paper as part of the operating assets that it contributed to Oi, S.A. ("Oi") of Brazil pursuant to the terms of a telecom merger between Portugal Telecom and Oi. In connection with the merger, the parties had valued Portugal Telecom's operating assets to be contributed at €1.75 billion as of December 31, 2013. The merger was consummated on May 5, 2014. On June 30, 2014, Portugal Telecom disclosed for the first time that its operating assets included €897 million in short-term commercial paper issued by Rio Forte. Rio Forte defaulted on the debt in July 2014, resulting in substantial losses and causing the parties to renegotiate the terms of the merger, with Oi returning the Rio Forte commercial paper to Portugal Telecom.

3. Portugal Telecom misrepresented the nature of the short-term investments in its December 31, 2013 fiscal year end financial statements and also failed to disclose the nature and extent of the credit risk to which it was exposed at December 31, 2013. In addition, Portugal Telecom's internal accounting controls were insufficient at December 31, 2013.

## Respondent

4. **Portugal Telecom, SGPS, S.A., now known as Pharol SGPS, S.A.** is a foreign private issuer incorporated in The Portuguese Republic with its principal place of business in Lisbon, Portugal. Portugal Telecom's American Depositary Shares ("ADSs") were registered with the Commission pursuant to Section 12(b) of the Exchange Act and traded on the New York Stock Exchange under the ticker symbol PT until Portugal Telecom delisted its ADSs effective March 30, 2015. On April 26, 2016, Portugal Telecom filed a Form 15F to terminate the registration of its ADSs. Portugal Telecom's ADSs now trade on OTC Pink market under the ticker symbol PTGCY. Portugal Telecom's 2013 financial statements were audited by Deloitte & Associados, SROC, S.A.

## Other Relevant Entities

5. **Oi S.A.** is a foreign private issuer incorporated in The Federative Republic of Brazil with its principal place of business in Rio de Janeiro, Brazil. Oi's ADSs are registered with the Commission pursuant to Section 12(b) of the Exchange Act and trade on the New York Stock Exchange under the ticker symbol OIBR. On June 20, 2016, Oi filed a petition for judicial reorganization.

6. **Grupo Espirito Santo (“GES”)** is a large Portuguese conglomerate of the Espirito Santo family. Its numerous entities<sup>1</sup> include:

**Espirito Santo International, S.A. (“ESI”)** is a GES holding company headquartered in Luxembourg. ESI filed for creditor protection on July 18, 2014.

**Rio Forte Investments, S.A. (“Rio Forte”)** is a privately held limited liability company incorporated in Luxembourg. Rio Forte, which is owned 100% by ESI, held and managed GES’s non-financial investments. Rio Forte filed for creditor protection on July 22, 2014.

**Banco Espirito Santo, S.A. (“BES”)**, one of Portugal Telecom’s three largest shareholders, previously was Portugal’s second largest bank. It collapsed in the summer of 2014 amid reports of irregularities and received a €4.9 billion bailout from the Portuguese government. BES had a 10.05% interest in Portugal Telecom at December 31, 2013, while Portugal Telecom owned a 2.1% interest in BES at December 31, 2013.

## Facts

### **A. The Oi/Portugal Telecom Merger**

7. In October 2013, Oi and Portugal Telecom announced that they had entered into a memorandum of understanding in which Oi would acquire Portugal Telecom’s operating assets for shares in Oi. A final merger agreement was signed on February 19, 2014.

8. The merger was conditioned upon, among other things, the successful completion of Oi’s capital raise. Oi issued approximately \$6.2 billion of new shares in a global equity offering in April 2014, including \$2.5 billion of shares Oi issued to Portugal Telecom in exchange for substantially all of Portugal Telecom’s operating assets. Oi’s global offering included \$1.2 billion of shares sold in the U.S. The global offering closed and the merger was consummated on May 5, 2014. Following the merger, Portugal Telecom held a combined direct and indirect interest of 39.7% in Oi.

9. In connection with the merger, the parties valued Portugal Telecom’s operating assets to be contributed at €1.75 billion (approximately \$2.5 billion) as of December 31, 2013. However, after the assets were valued but before they were contributed to Oi, Portugal Telecom invested in €897 million short-term commercial paper issued by Rio Forte, a privately-held GES holding company that managed GES’s non-financial investments. Portugal Telecom made this investment in February 2014 when the short-term investments it held at December 31, 2013 in another GES non-financial holding company, ESI, matured. Portugal Telecom then renewed the Rio Forte debt when it matured on April 15, 2014 (€847 million) and April 17, 2014 (€50 million).

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<sup>1</sup> The various Espirito Santo entities are referred to as GES or the GES entities.

10. In May and June 2014, several news articles reported concerns regarding the financial condition of ESI and other GES entities. Then, on June 26, 2014, news outlets reported that Portugal Telecom had bought Rio Forte commercial paper before Portugal Telecom merged with Oi. In a June 30, 2014 announcement, Portugal Telecom disclosed for the first time its investment in the Rio Forte commercial paper. In response to this news, the price at which Portugal Telecom's ADSs traded dropped more than 11% between June 27, 2014 and July 1, 2014.

11. In July 2014, Rio Forte defaulted on the commercial paper and, on July 22, 2014, filed for creditor protection. Thereafter, Oi and Portugal Telecom renegotiated the terms of the merger, with Oi returning the Rio Forte commercial paper to Portugal Telecom and Portugal Telecom surrendering a significant portion of the common and preferred Oi shares it had received in the merger. As a result of the renegotiation, Portugal Telecom's direct and indirect interest declined from 39.7% to 27.5%.<sup>2</sup> In January 2015, Oi sold the operating assets it had acquired from Portugal Telecom.

12. On August 25, 2014, in a Form 6-K, Portugal Telecom made supplemental and clarifying disclosures to its December 31, 2013 financial statements. Among other matters, Portugal Telecom disclosed for the first time that, as of December 31, 2013, its short-term investments included commercial paper in the total amount of €750 million issued by ESI, an unrated, non-financial GES holding company. Portugal Telecom also disclosed that the ESI investment represented 82% of its short-term investments at December 31, 2013. Portugal Telecom additionally disclosed for the first time the concentration of its cash deposits with BES and further that it had not implemented an effective investment diversification policy at December 31, 2013.

13. In August, 2014, Portugal Telecom's Board engaged PricewaterhouseCoopers ("PwC") in Portugal to conduct an independent analysis of Portugal Telecom's treasury applications with GES. Portugal Telecom disclosed the results of PwC's independent analysis in a Form 6-K filing on January 8, 2015.

## **B. Portugal Telecom's Misleading and Inaccurate Financial Statements**

14. Portugal Telecom's fiscal year end 2013 consolidated financial statements were misleading and inaccurate. These financial statements, which were prepared in accordance with International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board, were filed with the SEC on Form 6-K on March 12, 2014 and also included in Portugal Telecom's 2013 annual report filed with the SEC on Form 20-F on April 30, 2014.

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<sup>2</sup> Prior to the merger, Portugal Telecom owned a direct and indirect economic interest of 23.2% in Oi.

## **1. Portugal Telecom’s Mischaracterization of Short-Term Investments**

15. In its 2013 financial statements, Portugal Telecom mischaracterized its short-term investment in ESI commercial paper. Specifically, in footnote 24 entitled “short-term investments” to Portugal Telecom’s December 31, 2013 financial statements, Portugal Telecom mischaracterized its €750 million investment in ESI commercial paper as “debt securities issued by PT Finance and Portugal Telecom.” This disclosure was misleading and inaccurate because the debt securities were not *issued by* Portugal Telecom but rather *subscribed to* by Portugal Telecom (or its subsidiary PT Finance). Footnote 24 was also incomplete because it failed to identify the issuer of the securities – ESI, a GES holding company – and thus did not allow a user of the financial statements to evaluate the credit risk to which Portugal Telecom was exposed.<sup>3</sup>

16. Portugal Telecom corrected this error in its August 25, 2014 supplemental disclosures by disclosing that the “total amount of Euro 750 million includes debt securities issued by [ESI].” Portugal Telecom further disclosed that ESI was a “non-financial holding company” and part of GES.

## **2. Portugal Telecom’s Credit Risk Disclosure Failures**

17. Portugal Telecom failed to disclose the nature and extent of the credit risk to which it was exposed at December 31, 2013, as required by IFRS No. 7, *Financial Instruments: Disclosures*. The objective of IFRS No. 7 is to provide information that enables users to evaluate: (1) the significance of financial instruments for the entity’s financial position and performance; and (2) the nature and extent of risks arising from financial instruments to which the entity is exposed and how the entity manages those risks. As an initial matter, Portugal Telecom did not disclose that €750 million was invested in commercial paper at December 31, 2013, or that this amount was concentrated in debt issued by ESI, a non-financial holding company, as discussed above. Portugal Telecom also failed to disclose information about the credit quality of these financial assets, which were not rated, as required by IFRS No. 7, ¶ 36(c) (an entity is required to disclose information about the credit quality of financial assets that are neither past due nor impaired). As a result, investors were unable to form an overall picture of the nature and extent of risks arising from these financial instruments, particularly since the investments in ESI debt represented 82% of Portugal Telecom’s short term investments and 29% of its short-term investments plus cash and cash equivalents at December 31, 2013. The ESI debt also represented 40% of Portugal Telecom’s December 31, 2013 equity.

18. Portugal Telecom also failed to accurately disclose its objectives, policies, and processes for managing its exposure to credit risks arising from financial instruments, as required by IFRS No. 7, ¶ 33 (qualitative disclosures). At December 31, 2013, Portugal Telecom disclosed in footnote 45.1.3: “Risks related to treasury activities result mainly from the cash deposits on investments made by [Portugal Telecom and its subsidiaries]. In order to dilute these risks,

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<sup>3</sup> In contrast, Portugal Telecom disclosed in footnote 24 the identity of the issuers of its other short term investments at December 31, 2013, which totaled €162 million.

Portugal Telecom’s policy is to invest its cash for short time periods, entering in agreements with reputable financial institutions and diversifying counterparties.” Portugal Telecom’s footnote 45.1.3 disclosure was misleading and inaccurate for several reasons.

19. First, it had failed to implement effective diversification as of December 31, 2013, as Portugal Telecom admitted in its August 25, 2014 supplemental disclosures, stating: “With respect to the information on our policy on investments in cash and short-term investments, as presented in general terms in the Report and Consolidated Financial Statements...and in particular the criterion for investments in diversified financial institutions that are reputable in the market, it should be mentioned that, given the concentration in deposits and treasury applications in BES/GES, as of December 31, 2013, the Company was not implementing an effective diversification.” Notably, 82% of Portugal Telecom’s short-term investments and 85% of its cash and cash equivalents were invested in/deposited with BES/GES entities at December 31, 2013; nevertheless, Portugal Telecom failed to disclose the magnitude of its aggregate exposure to BES/GES entities in either its March 12, 2014 Form 6-K or fiscal year end 2013 Form 20-F.<sup>4</sup>

20. Second, Portugal Telecom’s short-term investments were not invested for short time periods. PwC reported that although Portugal Telecom’s investments were always papered as short-term investment (less than 180 days), the investments were successively rolled over. PwC concluded that such investments exceeded Portugal Telecom’s own 180-day policy for short-term investments.

21. Third, the short-term investments were not invested with a “reputable financial institution” at December 31, 2013. Rather, the funds were invested in debt issued by ESI, a non-financial holding company of GES and, as noted above, the investments were not rated.

### **C. Portugal Telecom’s Insufficient Internal Accounting Controls**

22. Portugal Telecom’s internal accounting controls surrounding its investments were insufficient at December 31, 2013. Contrary to Portugal Telecom’s stated policy to invest its cash for short time periods and to enter into agreements with reputable financial institutions and diversified counterparties, Portugal Telecom invested significant amounts of its cash in GES financial instruments over a period of 14 years beginning in 2001. PwC identified numerous control issues that allowed these investment policy violations, including the following:

- In 2003, Portugal Telecom created a monthly dashboard report entitled “Tableaux de Bord,” which reflected Portugal Telecom’s financial position at certain points in time. Although these reports were to be approved by Portugal Telecom’s executive committee, they were not regularly presented and, when presented, failed to include the correct description of the issuers of short-term investments (*e.g.*, ESI/Rio Forte) until

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<sup>4</sup> Although Portugal Telecom disclosed transactions and balances with its “major shareholders,” which included BES, in its March 12, 2014 Form 6-K and 2013 Form 20-F, it specifically excluded from this disclosure outstanding balances related to bank deposits, short-term investments, such as the ESI debt securities, and financings.

Portugal Telecom's then CFO presented a revised report to Portugal Telecom's executive committee on July 2, 2014.

- In 2004, the executive committee delegated the authority to Portugal Telecom's CEO and CFO, among others, to invest surplus treasury amounts by any method that was legally permitted, with maturities not in excess of 180 days. Although the investments in GES securities typically were on a short term basis (less than 180 days), the investments were successively rolled over. As a result, the successive periods during which money was invested exceeded the established limit of 180 days.
- In 2010, Portugal Telecom implemented procedures and internal control mechanisms to ensure identification, approval, and disclosure of transactions with qualified shareholders such as BES and their related entities. Such transactions, if over €100,000, were to be approved only after a prior favorable opinion of its audit committee had been obtained. Such transactions were further subject to approval by its board of directors if the aggregate value exceeded €1,000,000. The procedures were updated in 2011 to exempt transactions undertaken at market terms, although Portugal Telecom had no procedures to ascertain whether transactions were at market terms. As a result, transactions with GES entities were never subjected to review by Portugal Telecom's audit committee or approval by its board of directors.
- Portugal Telecom failed to implement controls and procedures to ensure compliance with its credit risk management policy, which limited its short-term investments to reputable financial institutions and diversified counterparties. For example, Portugal Telecom performed no credit risk analysis before investing in the debt of GES entities. Portugal Telecom also failed to perform any market consultations.
- Many ESI investments were made informally and without evidence concerning who made the investment decision or who authorized the investment. Moreover, PwC identified investments in ESI bonds for which term sheets and/or prospectuses were received only after the investment; for other ESI bonds, supporting documents lacked relevant information, such as interest rates and maturity dates, or were not signed by the issuer.
- In May 2013, Portugal Telecom issued notes in the aggregate amount of €1,000 million at a fixed rate of 4.625% and maturing on May 8, 2020, €500 million of which was used to subscribe to ESI bonds even though Portugal Telecom's internal policies authorized the investment of "surplus treasury amounts" only.
- Portugal Telecom had no controls in place to assess whether short-term investments were impaired.

23. In July and August 2014, Portugal Telecom's audit committee identified many of these same weaknesses and further concluded that the company had failed to comply with its own credit risk management policies regarding diversification and counterparties. Specifically with

respect to counterparties, the audit committee found that short-term investments were improperly made with non-financial holding companies, whose “good market reputation was not adequately evidenced.” The audit committee also concluded that Portugal Telecom’s internal controls manual lacked specific procedures relating to investments in short-term securities.

### **Violations**

24. As a result of the conduct described above, Portugal Telecom violated Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-16 thereunder, which require every issuer of a security registered pursuant to Section 12 of the Exchange Act to file with the Commission information, documents, and annual reports as the Commission may require, and mandate that periodic reports contain such further material information as may be necessary to make the required statements not misleading.

25. As a result of the conduct described above, Portugal Telecom violated Section 13(b)(2)(A) of the Exchange Act, which requires issuers to make and keep books, records, and accounts which, in reasonable detail, accurately and fairly reflect their transactions and dispositions of their assets.

26. As a result of the conduct described above, Portugal Telecom violated Section 13(b)(2)(B) of the Exchange Act, which requires issuers to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that: (i) transactions are executed in accordance with management’s general or specific authorization; and (ii) transactions are recorded as necessary to permit preparation of financial statements in conformity generally accepted accounting principles or any other criteria applicable to such statements, and to maintain accountability for assets.

### **IV.**

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent’s Offer.

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 21C of the Exchange Act, Respondent Portugal Telecom cease and desist from committing or causing any violations and any future violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-16 thereunder.

B. Respondent Portugal Telecom shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of \$1,250,000 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. §3717.

C. Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center  
Accounts Receivable Branch  
HQ Bldg., Room 181, AMZ-341  
6500 South MacArthur Boulevard  
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Portugal Telecom as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Victoria A. Levin, Assistant Regional Director, Division of Enforcement, Securities and Exchange Commission, Los Angeles Regional Office, 444 South Flower Street, Suite 900, Los Angeles, California 90071.

D. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Brent J. Fields  
Secretary