

Latin America

BAKER & MCKENZIE

Doing Business in Brazil



2006

Doing Business in Brazil

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Importing into Brazil

Import Licensing

Imports into Brazil are subject to government control from at least three levels of authority: the Secretary of Foreign Trade (SECEX) who supervises registration and licensing, the Central Bank of Brazil which approves payments for financed imports, and the Federal Tax Authorities, which supervises valuation for customs purposes. This is exercised through an electronic control system named SISCOMEX which includes a network linking the Federal Tax Authorities, the Central Bank of Brazil and SECEX. Taking the first step in the importation process, the proposed importer must register with the SISCOMEX.

There are three kinds of imports:

1. those not subject to any kind of licensing,
2. those automatically licensed, and
3. those not automatically licensed.

The cases of automatically and non-automatically licensed importation are provided for in the SISCOMEX.

The importation of certain goods not subject to licensing does not need any authorization from the Brazilian authorities prior to shipment thereof to Brazil or clearance through customs. Products imported under the temporary admission regime and products entitled to a reduction of the import duty through an “Ex-Tarifário” are not subject to licensing. In this case, the Brazilian importer must register only the Import Declaration when the products undergo customs clearance.

On the other hand, the automatic or non-automatic licensed imports are subject to prior examination and special control by certain governmental agencies, **before the shipment of goods from abroad**. In special circumstances, such as importing goods under the drawback regime, the import may be subject to prior examination and special control by certain government agencies, after the goods are shipped but before these go through customs clearance procedures.

Certain products, such as arms and ammunition, herbicides, pesticides and beverages, and narcotic substances, human blood and food, are subject to approval and special control by particular governmental agencies.

SECEX may deny an import license whenever there is reason to believe that the importation may negatively interfere in free trade, manipulate prices to the detriment of the Brazilian balance of trade, constitute dumping or unfair competition, or to pose a risk to the national economy. SECEX may also refuse to issue an import license for products shipped from countries that discriminate against Brazilian products.

Price Control

If an importer sets too low an invoice value on its goods for import, the government is deprived of its rightful share of duties and taxes; if it sets too high a value, the result may be an excessive remittance of foreign currency, in violation of exchange controls. For these reasons, SECEX strictly monitors the prices of imported products.

Accordingly, SECEX requires the Brazilian importer to submit the foreign exporter's price lists and catalogs. If no catalogs or price lists are published by the exporter, SECEX may accept a "pro forma" invoice. If SECEX believes that the prices quoted are not commensurate with international prices, it may require a statement from the exporter that the prices are in fact normal in the exporter's market.

SECEX will compare prices submitted by the exporter with prior import prices (if the products have previously been imported into Brazil) and with information provided by branches of the Banco do Brasil S.A. If SECEX determines that the importer is consistently over – or under-invoicing, it may impose penalties on the importer, ranging from suspension to cancellation of registration, thereby effectively preventing the importer from obtaining further import licenses.

In addition, if SECEX's price evaluation indicates that the prices are below normal international market levels prevailing under similar circumstances, it may set the price for customs duties and taxes at a higher level, as determined by SECEX's information sources.

Agents

Commission agents may be paid either in Brazil in the national currency, or abroad as part of the import price. No minimum or maximum percentage is set on commissions, although they seldom exceed ten percent (10%) of the import value.

Local Similarity Test

To qualify for special tax or financial benefits or incentives, an import must meet the “local similarity test” (*teste de similaridade nacional*). This test is conducted when SECEX confirms that a similar product is not available in Brazil.

Imports of Used Products

Although used products may be imported, SECEX subjects them to very strict scrutiny to avoid fraud in connection with obsolete products. Moreover, used products may be imported only if the same or similar products are not available from Brazilian producers, and if the importation thereof is in the interest of the national economy.

Temporary Admission Regime

Under Law No. 9,430 of December 30, 1996, equipment imported under temporary admittance for economic utilization in Brazil will be subject to taxes levied on importation, based on the period the respective goods remain in the country. This provision is regulated by Article 306 of the Brazilian Customs Regulations, approved by Decree No. 4.543 of December 27, 2002.

Bonded Warehouse

Importers may also deposit imported goods in public bonded warehouses. The products will remain in the custody of customs officials. The importer will pay no customs duties (but storage fees only) until the products leave the bonded warehouses for consumption in the domestic market. The importer will pay no customs duties if the product is reexported. Note that certain manufacturing activities are allowed within the premises of these warehouses.

Leasing

International leasing is acceptable to SECEX under special financial conditions approved by the Central Bank of Brazil.

Exchange

Once the SECEX-approved products are effectively imported, the Brazilian importer will be allowed to exchange local currency for the currency agreed upon with the exporter and to pay the import price through regular banking channels. Imports payable within a period that exceeds 360 days are subject to registration by the Central Bank of Brazil, through the *Registro de Operações Financeiras* (“ROF”).

Taxes on Imports

Taxes or duties on imports include: import tax (“II”), due on the CIF import price at selective rates; IPI, due on the import price grossed up by the import tax and based on selective rates; ICMS, due on the CIF import price grossed up by the import tax, IPI, PIS/COFINS (explained below) and ICMS (rates of ICMS are eighteen percent [18%] in most states); and maritime transport fee (AFRMM), due on the value of freight (usually at the rate of twenty-five percent [25%]). As of May 1, 2004, the importation of goods into Brazil is also subject to the Contribution to the Social Integration Program (“PIS”) and Contribution for Social Security Financing (“COFINS”). PIS/COFINS are due on the import price grossed up by the ICMS (calculated only on the CIF import price grossed up by the import tax, IPI, and ICMS) and the PIS/COFINS itself at a combined rate of 9.25%.

Taxes are based on the price negotiated between exporter and importer and approved by SECEX, plus import costs. Customs agents may question the tax basis, demand a higher basis for tax purposes and impose penalties on the importer, depending upon the circumstances. Under- and over-invoicing are subject to a penalty of 100 percent of the under- or over-invoiced difference.

Freight

As a general rule, transport costs for products imported into Brazil may be settled with non-Brazilian flag carriers. There are some exceptions to this rule such as importation with tax exemptions. In these cases, freight services must be contracted with Brazilian vessels.

Insurance

Coverage of imported goods must be provided by insurance companies established in Brazil. Brazilian importers may only contract FOB or C&F terms, not CIF or C&I, because the amount corresponding to the insurance may not be transferred abroad.

Latin American Integration Agreement

(LAIA or ALADI). Brazil is a member of the Latin American Integration Association (LAIA or ALADI), instituted by the Treaty of Montevideo of August 12, 1980. ALADI members grant preferential duty treatment to one another. The ALADI community includes Argentina, Bolivia, Brazil, Colombia, Ecuador, Mexico, Paraguay, Peru, Uruguay, Cuba and Venezuela.

Southern Cone Common Market (MERCOSUL)

Brazil is also a member of the Southern Cone Common Market, or Mercado Comum do Sul (MERCOSUL). MERCOSUL currently functions as a free trade zone and a customs union, except for some products that are still subject to quotas (e.g., vehicles). MERCOSUL now allows most goods and services to circulate among its members exempt from tariff and non-tariff barriers, and provides for a common external tariff (*tarifa externa comum*, or TEC) for most products that the member countries import from non-MERCOSUL countries. At this point, TEC has not been applied to certain products such as computers, automobiles and capital goods. However, schedules for gradual harmonization of the tariffs have been agreed upon and should lead to a uniform TEC by target year 2006. MERCOSUL has executed treaties providing for duty preferences with Bolivia, Chile, Mexico and Peru and is negotiating treaties with the European community and with NAFTA.

Manaus Free Trade Zone

The free trade zone of Manaus is designed to encourage manufacturing for export and local sales. Raw materials, parts and components imported into the Manaus free trade zone enjoy deferment and reduction of customs duties and exemption of federal excise tax (IPI). These benefits apply only to merchandise entering the free trade zone by Manaus Airport or Manaus Harbor. They do not apply to the importation of weapons and ammunition, perfumes, tobacco products, beverages or automotive vehicles. Constitutional Amendment No. 42/03 extended the applicability of these benefits until 2023.

[Revised as of September 2006]

Exporting from Brazil

Export License

Exports from Brazil are also supervised by the Secretary of Foreign Trade (SECEX) and by the Central Bank of Brazil. SECEX is simplifying legal requirements regarding exportation of goods. Currently, exporters must be registered with SISCOMEX.

Export Incentives

The Program for the Financing of Exports (PROEX) provides financing to exporters. Exporters may also benefit from exemption from the Federal Excise Tax (“IPI”), immunity from the State Value-added Tax on Sales (“ICMS”), and exemption from the Social Welfare Taxes (“COFINS” and “PIS”). (Please see item Taxes on Export.)

Drawback Incentive

Another export incentive is available under the Drawback System (Ordinance SECEX No. 14, of November 17, 2004). This benefit takes the form of a deferral or exemption from taxes on importation of raw materials, semi-finished and finished products, parts and components utilized in the manufacturing of products for export.

RECOF

The RECOF is a special customs regime called industrial bonded warehouse regime under electronic control system. Under this regime, the importer is entitled to the suspension of the federal taxes levied upon importation of goods (i.e., the Import Duty – II, the IPI, PIS/COFINS) to be used in the manufacturing process of products to be exported. This regime applies only to products expressly listed by the applicable regulation, such as electronic and telecommunication products, automotive products, aeronautical products and semiconductors.

To be entitled to the RECOF, the Brazilian company must have a minimum net equity and assure minimum exports. The RECOF regulations allow the beneficiary to have part of the imported goods sold in the local market. After the goods are sold in the local market, the beneficiary must pay the taxes levied upon importation of such goods.

Exchange

Pursuant to Brazilian export and exchange control regulations, exports must be carried out with exchange coverage (i.e., actual payment which ensures inflow of funds to Brazil). The applicable regulations list very few exceptions in which the export may be carried out without exchange coverage (i.e., without payment to the Brazilian exporter), such as capital contribution and temporary export regime.

Taxes on Exports

The Brazilian Constitution provides that Brazilian export products are entitled to tax immunity with respect to the Federal Excise Tax (“IPI”), to the State Value-added Tax (“ICMS”) and to PIS/COFINS, regardless of whether these products are manufactured in Brazil or not.

Moreover, the Brazilian governmental tax policy tends to reduce the tax burden applicable to exports from Brazil. Thus, most export operations from Brazil are not subject to taxes, except for certain export products (such as leather) which are subject to Export Tax (“IEx”). This tax applies on an *ad valorem* basis at rates that vary depending on the type of product exported.

[Revised as of September 2006]

Intellectual Property – Protection, Enforcement and Licensing

The Industrial Property Law (“the IP Law”) is the primary law in the area of patents, trademarks, industrial designs and geographical indications, and regulates registration thereof with the Brazilian Patent and Trademark Office (“INPI”).

The IP Law is a modern statute that meets most recent requirements of the World Trade Organization (WTO) legislation related to industrial property rights (commonly referred to as TRIPS). In addition to affiliation to the WTO, Brazil is a member of several international conventions and agreements such as the Paris Convention and the Patent Cooperation Treaty for the protection of industrial property rights.

Patents

a) Patent Categories

The IP Law provides for two types of patents: inventions and utility models. An invention is an original concept that represents a solution for a specific technical problem and may be industrially manufactured or used. A utility model has recently been introduced into a known product with a practical purpose, improving its use or manufacture thereof.

b) Non-patentable Inventions and Utility Models

Inventions and utility models that are contrary to moral and good practices or to public safety, order and health are not patentable. Likewise, substances or products of any kind resulting from the transformation of the atomic nucleus are not patentable. Besides, living beings, in whole or in part, are not subject to patent protection either, except for transgenic microorganisms which present the prerequisites of patentability and provided that they are not mere discoveries.

c) Prerequisites

There are three prerequisites for the patentability of a creation: novelty, inventive activity and applicability for industrial use. In order to be granted patent protection, the invention must be considered new, i.e., not included in the state of the art.

The state of the art comprises everything that has been made available to the public, either by written or oral description, by usage or any other means, in Brazil or abroad, before the filing date of the application. The requirement of an inventive activity will be complied with whenever, per an expert's opinion on the subject, the invention does not result from the state of the art in an evident or obvious manner. As a third prerequisite for patentability, the invention must be capable of being applied (i.e., used or produced) in the industry.

d) Priority

A right of priority shall be granted to the application filed in a country which has entered into a treaty with Brazil or which is a member of an international organization of which Brazil is also a member, during the terms provided therein, such as the Paris Convention. According to the Paris Convention, the priority-claiming term is one year for a patent of invention, and six months for a utility model.

e) Validity

The patent for inventions is valid for twenty years; and the patent for utility models, for fifteen years, counted as of the date of filing of their respective applications.

f) Scope of Protection

The patent provides its owner protection against unauthorized manufacture, use, marketing, sale or importation of the patented product, or of the process or product directly obtained from a patented process, by third parties, except when the unauthorized use is for noncommercial or experimental purposes that do not harm the patent owner's economic interests.

g) Compulsory Licenses

According to the IP Law, patents may be subject to compulsory licensing to be granted by the INPI or by the Federal Government in the following circumstances:

- (i) if the patent holder exercises his/her rights in an abusive manner or exercises, through the patent, economic power abuse, which must be evidenced by an administrative or Court decision;
- (ii) in case the patent is not fully exploited in Brazil within three years after the patent grant, for reasons other than lack of economic viability;

- (iii) if the sale of the patented product or product obtained through a patented process does not meet the market's needs;
- (iv) in case of a dependent patent that represents substantial technical progress vis-à-vis the original patent; or
- (v) in case of national emergency or public interest (including interests related to public health and environmental protection), declared by the Federal Government, if the patent holder or licensee does not fulfill such needs.

Such compulsory licenses may be requested by any interested third party, provided that such third party is technically and economically qualified to carry out the efficient exploitation of the patent. The products resulting therefrom must be earmarked mostly for the Brazilian domestic market. Compulsory licenses will be granted only on a non-exclusive basis.

h) Certificate of Addition

The IP Law also provides protection for an improvement or development introduced into the subject matter of an invention by granting a Certificate of Addition, which is added to the letters-patent. The validity of the certificate of addition shall be the same as that of the corresponding patent.

i) Extinction of Patent Rights

In addition to the extinction of the patent protection due to expiration of its validity term, the waiver, lack of payment of any annual fee, forfeiture for failure to cure the abuse or misuse of the patent, or the lack of appointment of an attorney in Brazil to receive summons, will cause the extinction of the patent.

Industrial Designs

a) Creations Valid for Registration

An industrial design is a two-dimensional representation (ornamental assembly of lines and colors) or three-dimensional object (ornamental plastic form) that may be applied to a product, affording a new and original look in its external configuration and which may be used for industrial production.

b) Prerequisites

The prerequisites for the registration of an industrial design are novelty and originality. The definition of novelty is the same as that applied to patents. The prerequisite of originality shall be met if the industrial design has an original and distinctive visual configuration when compared to other previously known objects. A common or ordinary form of an object, or those determined by technical or functional considerations, are not considered industrial designs. Immoral designs do not qualify for registration, as well as purely artistic works.

c) Validity

The registration is valid for ten years and may be renewed for three successive periods of five years each, and a renewal fee must be paid every five years.

Trademarks

a) Signs Qualified for Registration as Trademark

Any visually perceptible, distinctive sign not prohibited by law qualifies for registration as a trademark. The IP Law has permitted registration of three-dimensional trademarks but audio or olfactory trademarks do not qualify for trademark protection in Brazil.

b) Signs not Qualified for Registration as Trademark

The following, among other things, cannot be registered as trademarks: any expression or sign which is immoral, offensive or discriminatory; signs commonly used to describe the nature of a product or service; advertisement slogans and colors; false indications of geographical origin; civil names or signatures, except upon consent of the holder of the right; technical terms used in connection with the product or service; reproductions or imitations of a mark belonging to a third party for identical, similar or related products; common or necessary forms or packaging of the product; and the reproductions or imitations of a mark that cannot be ignored by those that work in the field of activity in which the trademark is used.

c) Trademark Categories

Trademarks are divided into three categories:

- (i) products or service marks used to distinguish between two products or services;
- (ii) certification marks used to assert the compliance of the product or service with certain standards of quality or technical specifications; and
- (iii) collective marks used to identify products or services from members of a certain group.

d) Validity

Trademarks are registered for a ten-year period and renewable for identical and successive terms.

e) Prerequisites

Any individual, private or public entity may apply for the registration of a trademark in Brazil, provided that the applicant may claim only classes related to the business activity in which an individual or entity is engaged, directly or through controlled companies. The applicant for a collective mark must be a legal entity that represents the collectivity, and the applicant for a certification mark may include a person without commercial or industrial interest in the certified product or service.

f) Priority

A right of priority will be granted to the application filed in a country which has entered into a treaty with Brazil or which is a member of an international organization of which Brazil is also a member, during the terms provided therein. The priority term provided in the Paris Convention for trademarks is six months.

g) Famous and Well-Known Marks

Special protection shall be afforded to a registered trademark deemed famous in Brazil, covering all classes of products and services. The trademark considered well-known in the field of activity in which it is used, pursuant to the Paris Convention, is also afforded special protection, regardless of whether it has been previously filed or registered in Brazil. This also applies to service marks.

Geographical Indications

According to the IP Law, the following qualify for protection as geographical indication and may be registered with INPI:

- (i) geographical names of countries, cities or regions which became known as centers for extraction, production or manufacture of a certain product or rendering of a certain service; or
- (ii) geographical names used to designate the qualities and features of products or services due exclusively or essentially to the geographical environment.

The name of a geographical region commonly used to designate a product or service will not be considered a geographical indication. Only those manufacturers or service providers that are actually established in the geographical area shall be allowed use of the corresponding geographical indication.

Copyrights

a) Scope of Protection and Requirements

The Brazilian Copyright Law provides for the protection of intellectual and creative works (and those expressed in any physical media) such as literary, artistic, scientific or photographic works, architectural projects, designs, paintings, among many other things. The protection of copyrights in Brazil does not depend on registration of the work with any government authority. Notwithstanding, the author may register the work to indicate, among other things, the date of creation of the work. Copyrights in Brazil comprise the economic rights of author and his/her moral rights. Such moral rights cannot be licensed, transferred or waived. As to his/her economic rights, the protection of copyright lasts for seventy years as of January 1st of the year following the author's death or as of the work's first publication, in case of anonymous or pseudonymous works, audiovisual and photographic works.

b) Limitations to the Author's Rights

According to the Copyright Law, the following actions, among other things, do not represent infringement of copyright:

- (i) reproduction in daily newspapers and other publications of news or articles previously published, provided that the author's name (if signed) and the original publication are mentioned;
- (ii) reproduction, in only one sample, of small parts of the work for private use of the person who has made the copy, provided that the person himself/herself has written it with no profit purposes;
- (iii) use of literary, artistic or scientific works, phonograms and television and radio transmission in commercial establishments, exclusively for the purpose of demonstrating the same to customers, or for establishments that commercialize the equipment or supports that allow such use of the works.

Software

a) Scope of Protection and Requirements

The Software Law grants software copyright protection and defines a computer program as “the expression of an organized set of instructions in natural or codified language, contained in a physical media of any kind, and necessarily applied in automatic machines for information processing, devices, peripheral instruments or equipment, operated under digital or analogue techniques which make them work in a certain way and for a certain purpose”. In spite of the same protection regime applied to copyright, the Software Law provides that the moral rights of author do not apply to computer programs, except for the right of the software creator to assert its authorship and to oppose unauthorized alterations of the software that may damage his/her honor and reputation. The protection of software does not depend on registration of the program and lasts for fifty years, as of January 1st of the year following the publication or creation of the software. The author may, however, register the software and, in this case, the application for registration must be filed with INPI. In case of any transfer of technology of software, registration of the related agreement with INPI is then required and the delivery of the complete documentation, source code and additional information by the supplier to the technology recipient is mandatory under the law.

b) Limitations to the Author's Rights

According to the Software Law, the following actions do not represent infringement by the copyright holder over the software:

- (i) reproduction of one copy of the software, by one who has acquired a legal and regular program, for backup or electronic storage;
- (ii) citation of part of the software for educational purposes, provided that the protected work and its author are indicated in the citation;
- (iii) similarity between computer programs, arising from functional characteristics of their application or from the compliance with legal and technical requirements;
- (iv) integration of the software with an application or operational system that is technically essential for the user's needs, provided that the basic characteristics of the software are maintained and that the integration is for the sole use of the person who has carried it out.

Enforcement of Intellectual Property Rights in Brazil

The intellectual property laws also include provisions pertaining to crimes and violations of rights and provide for remedies in case of infringement of intellectual property rights. Below are examples of the most useful remedies available:

a) Extrajudicial cease-and-desist letter

The purpose of the cease-and-desist letter is to make the infringing party aware of the corresponding violation and it may also constitute an effective means of obtaining a settlement between the parties.

b) Judicial cease-and-desist letter

The purpose of such cease-and-desist letter is also to make the infringing party aware of the violation. However, the judicial cease-and-desist letter may be a more effective tool of obtaining a settlement with the infringing party due to its official and judicial character.

c) Administrative Appeals

The administrative appeals are used during the period of examination of applications for registration of industrial property rights with INPI, or immediately after such rights are granted. The competent agency to receive and decide on said appeals is INPI.

At the administrative level, a patent, trademark or industrial design may be declared null and void in the event of any formal flaw in the registration proceedings. The INPI may initiate the nullity proceeding itself or upon request of any third party having a legitimate interest, within a term of six months counted from the date of grant (for patents and trademarks) and five years from the date of grant (for industrial designs). The industrial property owner may reply to such declaration and the President of INPI shall decide the appeal, closing the administrative level.

In addition to such nullity proceedings, a legal nullity action may be pursued before a Federal Court.

d) Preliminary Search and Seizure procedures

The owner of an intellectual property right (either copyright and software, or industrial property rights such as those that involve trademarks, patents and industrial design) has two different avenues by which to obtain a search-and-seizure order regarding the infringing products: (a) the criminal procedure, in which the seizure will be limited to the number of samples of the counterfeit product sufficient to allow a technical examination, in crimes against intellectual property rights and unfair competition. In crimes against copyright and trademark (when the imitation of the trademark is obvious), all the products illegally produced or reproduced are object of the seizure; and (b) the civil procedure, in which the seizure will include all the counterfeit material, related manufacturing equipment, molds, packaging and advertising materials.

For this order to be granted, proof of counterfeiting must be unequivocal and the risk of financial losses and irreparable damages to the intellectual property right owner must be accurately evidenced.

e) Injunctions

It is possible for intellectual property right owners to obtain injunctions against infringers so that they are forced to cease the manufacturing, launching, use,

reproduction, offering for sale, sale or import of the infringing products in the market, either in order to prevent irreparable harm caused by the infringement and the delay in having a final court decision, or to anticipate the effects of the final decision in view of strong evidence that plaintiff's claim is well-grounded. In both cases, strong evidence of the alleged infringement and of potential irreparable harm to the plaintiff must be submitted to the judge.

f) Ordinary Civil Lawsuit

An ordinary civil lawsuit is usually filed against the infringing party for three purposes: (i) discontinuance of any unauthorized use of the corresponding intellectual property right; (ii) imposition of a fine for noncompliance with the discontinuance of the use thereof; and (iii) compensation for losses and damages caused through counterfeiting.

With regard to the collection of losses and damages, the IP Law establishes that the loss of profits is determined by the following criteria, whichever is most favorable to the industrial property right owner: (i) the profits that would have been obtained by the industrial property right owner if the infringement had not taken place; (ii) the profits obtained by the infringing party; or (iii) the compensation that the infringing party would have paid to the industrial property right owner for a license that would have allowed it to lawfully exploit the object of the rights.

g) Crimes against Industrial Property and Unfair Competition

The IP Law provides for the following criminal penalties in case of violation of industrial property rights:

- (i) imprisonment from three months to one year, or a fine, in case of
 - (a) unauthorized use or manufacture of products whose application for a patent is pending;
 - (b) reproduction or alteration of a trademark; and
 - (c) manufacture of products whose application for industrial design has been approved; and
- (ii) imprisonment from one to three months for other cases such as use of trademark or advertisement expression to indicate false origin of a product, or use of false geographical indication. Such penalties may be increased when

the violating party is a sales representative/agent; an authorized individual, company, partner or employee of the industrial property owner or its licensee, and also if the violated trademark is a famous, certified or collective mark.

The IP Law also treats as crimes certain unfair competition practices, such as the disclosure or employment of fraudulent means or false statements for the purpose of obtaining an advantage vis-à-vis a competitor; the diversion of clientele; the deliberate misleading of consumers; the unauthorized use of a third party's corporate name or confidential information, and other fraudulent acts. The IP Law provides for a penalty of imprisonment of three months to one year, or a fine. These actions, as well as other unfair competition practices not defined as crimes, are subject to civil lawsuits and may entitle any competitor harmed by such practices to losses and damages.

In such crimes, the prosecution of the infringer depends on the request of the holder whose rights have been violated.

h) Crimes against Copyrights

The Criminal Code establishes that the partial or total reproduction of a copyrighted work with economic purpose, without the author's express authorization, constitutes a crime and subjects the agent to a penalty of two to four years of imprisonment. The same penalty applies to the one who distributes, sells, offers for sale, rents, introduces in the country, acquires or keeps in storage, original or copy of a copyrighted work reproduced in violation of the author's rights. In both cases, the Public Attorney may initiate the criminal claim, taking into account the relevant public interest involved in the issue, regardless of the initiative of the victim.

A penalty of two to four years of imprisonment is applied to the one who offers, without the author or performer's express authorization, to the public any copyrighted work by means of cable, optical fiber, satellite, waves or any other system.

The Software Law also establishes that the violation of software copyrights is a crime, and shall subject the infringer to imprisonment of six months to two years, or a fine. In case such violation consists of the unauthorized reproduction of the software (or part thereof) for purposes of resale, the penalty shall include imprisonment of one to four years and a penalty.

i) Parallel Imports into Brazil

“Parallel import” is the unauthorized importation of an original product covered by a patent and/or trademark by a third party other than the legitimate holder of such patent and/or trademark or authorized licensees or distributors.

The Brazilian IP Law has adopted the national exhaustion of rights – that is, the owner of a Brazilian patent cannot impede the sale or use of a patented product or a product manufactured under a patented process if such product was placed in the Brazilian market by the patent owner or with his/her consent.

The same principle applies with regard to trademarks. The IP Law sets forth that the trademark owner cannot prevent the free circulation of a product bearing its trademark, if such product was introduced in the Brazilian market by the trademark owner or by a third party, with the trademark owner’s consent (except for certain specific situations regarding patented products subject to compulsory license or which manufacture in Brazil is not economically feasible).

Therefore, in case of parallel import, i.e., if the owner of the patent or trademark has not imported a legitimate product into Brazil or consented thereto, or manufactured under his/her patent or bearing his/her trademarks, the patent or trademark owner or authorized licensee may prevent the importation, seize the imported products and/or claim damages, depending on the factual verification.

j) Customs’ Control

The IP Law establishes that products bearing false, modified or imitated trademarks or false indications of origin may be seized by customs officers at the time of clearance, or upon the request of an interested party.

A different situation encompasses “gray market” products resulting from parallel import. As these products are not counterfeit, their import into Brazil does not constitute a crime, and consequently the customs officers cannot seize these products without a specific judicial order for this purpose.

Intellectual Property Licenses and Transfer of Technology

Types of agreements subject to registration with INPI

a) Supply of Technology Agreements

Agreements involving transfer of technology must be registered with INPI to be effective vis-à-vis third parties. INPI does not accept technology licenses and understands that the technology is permanently transferred to the Brazilian recipient. In view of that, INPI usually imposes certain restrictions in connection with the confidentiality and terms of the agreements, among other things.

Brazilian laws limit the tax deduction of payments remitted in consideration of the supply of technology. This limit varies according to the industry involved, reaching a maximum of 5%, calculated upon net sales of the products manufactured or the services rendered under the agreement, and includes payments in consideration for the transfer of technology, rendering of technical assistance and licensing of patents and trademarks in aggregate. In case of an agreement entered into with a foreign-related company, the same percentage applies as a limit for remittance of payments.

b) Specialized Technical Services and Technical Assistance Agreements

This category includes agreements regarding services that involve technology transfer (technical assistance agreements for the incorporation/absorption of the technology by the recipient company), or services related to the main industrial activity of the recipient company (i.e., specialized technical services in connection with the engineering project for a manufacturing facility, start-up of a production line or assembly and installation of industrial equipment, among other things). They are also subject to registration with INPI. Specialized technical services agreements entered into with a related company with headquarters abroad are subject to the Brazilian transfer pricing rules.

c) Patent License Agreements

Agreements for the license of patents applied for or granted in Brazil must be registered with INPI to be effective vis-à-vis third parties. The deduction and remittance caps mentioned above for supply of technology agreements also apply to the remittance of payments abroad in consideration of patent licenses.

d) Trademark License Agreements

Agreements for the license of trademarks registered or applied for in Brazil are subject to registration with INPI. Tax deduction of royalty payments for trademark licenses is capped at 1% of the licensee's net sales. In case of trademark license agreements entered into with a foreign-related company, INPI will allow only the remittance of royalties in consideration of the trademark license provided that the use of the trademark is not directly connected to products or services manufactured and/or rendered under a supply of technology, technical assistance and/or patent license agreement (in force) between the parties.

e) Franchise Agreements

Franchise has been legally defined as the system through which a franchisor grants to a franchisee the right to use his/her trademarks or patents, along with the exclusive or semi-exclusive right to distribute products or services and, in some cases, also with the right to use the technology for the implementation and management of specific businesses or operating systems developed by the franchisor.

Franchise Agreements are subject to registration with INPI to be effective vis-à-vis third parties. The Franchise Law sets forth franchisor's obligation to convey to the potential franchisee the corresponding franchise offering letters with certain information on the franchise, which must be delivered to the franchisee at least ten days before the execution of the contract (or letter of intent) or before any payments from the franchisee to the franchisor.

In case of an agreement with a foreign licensor or supplier of technology, the registration with INPI is also a condition precedent for the remittance of payments abroad and deduction of payments by the Brazilian licensee or recipient. After registration with INPI, such agreements must also be registered with the Central Bank of Brazil, as they call for payments in foreign currency.

Types of agreements not subject to registration with INPI

a) Professional Services Agreements

Agreements for the rendering of professional, consulting, administrative, financial or managerial services are not subject to registration with any Brazilian government authority. Payments thereunder may be remitted abroad through any commercial bank authorized to perform exchange operations upon presentation of the Agreement, its translation in Portuguese and the corresponding invoice. In order to qualify as professional services, these services cannot involve any license of intellectual property, transfer of technology or production of intellectual (scientific) knowledge. Professional services contracted abroad between related companies are subject to the deductibility limits established by the Brazilian transfer pricing rules.

b) Copyright Agreements

Except for certain specific cases, copyright agreements (such as editing agreements, agreements for assignment of rights, production agreements, agreements for future work of art, representation and execution agreements) are not subject to registration with any Brazilian government authority, and the applicable copyright fees may be remitted abroad without any registration. The regulation for such remittance is less strict than the rules covering the remittance of royalties and technical assistance fees, although the amount of the remittances may be reviewed by the Central Bank of Brazil as part of foreign exchange controls and by tax authorities. Certain types of copyright fees must be approved by government agencies, such as those related to audiovisual works. Copyright agreements contracted abroad between related companies are subject to the Brazilian transfer pricing rules.

c) Software Agreements

Software may be licensed in Brazil either

- (i) directly by the holder of the rights on the software or authorized licensor to end users or
- (ii) through a reseller, distributor or other similar vendor. In both cases, registration of the relevant agreement is not required.

Software license, maintenance and customization fees may be remitted abroad without any specific approval. There is no limit for the fees that may be remitted abroad under software agreements, provided however that, if such agreements are entered into between related companies, Brazilian transfer pricing rules shall apply.

Relevant Tax Burdens on Intellectual Property-related Transactions

a) Withholding Income Tax

Payments made to nonresidents in consideration for the license of patents and/or trademarks, technology transfer, technical assistance and specialized technical services, as well as in consideration for consulting and/or professional services that do not involve transfer of technology, license of software and/or copyrights are subject to the withholding income tax, currently levied at a general rate of fifteen percent (except for Treaties to avoid Double Taxation entered into between Brazil and other countries that set forth a lower rate). The remittance of certain types of fees may be subject to different tax rates, such as fees for services that do not qualify as technical or administrative assistance, which are subject to a 25% rate. The foreign company/recipient of payments abroad is the legal taxpayer of the withholding income tax, and the Brazilian company or individual is responsible for the payment. However, it is possible to establish in the agreement that the Brazilian company or individual shall bear the costs of such tax by grossing up the fees.

b) Contribution for Intervention in the Economic Domain (“CIDE”)

Payments made to nonresidents in consideration of:

- (i) supply of technology,
- (ii) technical assistance (technical assistance services and specialized technical services),
- (iii) technical services, administrative assistance and other similar services,
- (iv) trademark license and assignment, and
- (v) patent license and assignment are subject to the Contribution for Intervention in the Economic Domain (“CIDE”), levied at a rate of ten percent.

CIDE is exacted by the Brazilian Company and may not be deducted from such remittances of payments. Brazilian laws grant a credit of CIDE solely for remittances of payments under trademark and/or patent license agreements, to be used in future CIDE payments. Such credit amounts to seventy percent until 2008 and thirty percent until 2013. The scope of incidence of CIDE has been controversial with regard to remittances of payments abroad in consideration of software and copyright licenses, and depending on the circumstances, the Federal Revenue authorities understand that CIDE shall apply to such remittances as well.

c) Service Tax (“ISS”)

The Service Tax is a Municipal Tax, levied and regulated by each city, but under a common umbrella of Federal legislation that lists the services that trigger the ISS. ISS shall be levied on services rendered in Brazil and on “importation of services”, i.e., services originating from other countries or those initiated abroad. The exportation of services shall not be subject to ISS, except for services developed in Brazil whose results occur in Brazil, even if the payer is a foreign resident. In what regards intellectual property-related transactions, the most relevant services currently on the list are: information technology and similar services; research and development services of any nature; license of the right to use trademarks and slogans; installation and assembly of devices, machines and equipment; programming and visual communication; biotechnology services; services related to art works made for hire; and broadcasting of music, films, musicals and the like. The levy of ISS on some of the items of the list, e.g., trademark license, may give rise to questioning, on the grounds that in principle they do not qualify as rendering of services (upon which collection of the ISS tax is based). ISS rates may vary from two percent to five percent.

d) Contribution to the Social Integration Program and Contribution for Social Security Financing on Importation (“PIS/COFINS Import”)

The PIS/COFINS Import Law, effective as of May 1, 2004, provides for the levy of the PIS/COFINS Import on the import of goods and services, as a general rule, at a total rate of 9.25%. Pursuant to the PIS/COFINS Import Law, the triggering event for payment of such taxes shall be as follows:

- (i) entrance of foreign goods into the national territory, as well as the

- (ii) payment, credit, delivery, use or remittance of amounts abroad in consideration of services rendered.

As a general rule, the PIS/COFINS Import is exacted by the Brazilian company or individual who has contracted the services or imported the goods. The contributions apply on the total value of the imported goods including State Value-added Tax (“ICMS”) – with certain adjustments – and the amounts of the contributions themselves (PIS and COFINS Import). In cases of importation of services, the contributions apply on the amount paid, credited, delivered, used or remitted abroad, calculated before the Withholding Income Tax, plus the ISS and the amounts of the PIS and COFINS Import as well. Unlike the ISS, the PIS/COFINS Import Law does not provide for a list of the services subject to such contributions, and there is still no official understanding from the tax authorities. Notwithstanding, at least in principle PIS/COFINS Import may be applicable on certain intellectual property-related transactions, especially software and trademark licenses, as these are already deemed services provided under the ISS Law.

e) Contribution for Development of National Cinematographic Industry (“CONDECINE”)

In its effort to promote the Brazilian movie industry, the Contribution for Development of the National Cinematographic Industry is levied at a rate of eleven percent, on payments made to nonresidents in consideration of the exploitation, acquisition or importation of cinematographic and video phonographic works. CONDECINE is also levied once every five years, at a varying rate calculated according to the market segment and the scope of exhibition of commercially produced audiovisual works, on the exhibition, production, licensing and distribution of cinematographic and video phonographic works.

f) Financial Tax (“IOF”)

Previously, a financial tax of twenty-five percent was imposed on the net remittance of royalties, copyrights, software, technology, technical assistance and professional services fee payments to a foreign company. The IOF tax rate has been reduced to zero as of June 1997 for payments made under said agreements.

Other Intellectual Property Rights

a) Brazilian Biodiversity and Traditional Knowledge

The Brazilian Constitution has promoted the protection of biodiversity among its fundamental environmental principles. In this sense, a federal decree ratified the “International Convention on Biodiversity Protection”, signed during the United Nations Environmental Convention held in Rio de Janeiro in 1992. The Convention seeks to protect and preserve the biodiversity, the sustainable use of its resources and fair sharing of the benefits resulting from the use of genetic resources. In addition to the Convention, there are other relevant legal documents enacted to oblige individuals and legal entities, such as the Provisional Act that incorporates the principles and purposes of the Convention and regulates the access to genetic resources, traditional knowledge and creates mechanisms of benefit-sharing.

The Provisional Act establishes that the access to any genetic resource existent in Brazil and to any traditional knowledge associated thereto for purposes of scientific research, technological development or biodiversity prospecting is subject to the prior authorization of the Brazilian Genetic Resource Management Council (*Conselho de Gestão do Patrimônio Genético - CGEN*).

Only Brazilian public or private institutions which perform research and develop activities in the biological and related fields shall be authorized to have access thereto. The participation of foreign companies in expeditions to collect samples of any component of the Brazilian genetic resource and to access any traditional knowledge associated thereto shall be authorized only if it occurs jointly with a public national institution that must coordinate the activities.

Additionally, if there is any perspective of commercial use of the genetic resource and/or the traditional knowledge associated thereto, it is also necessary to execute an “Agreement for Use of Genetic Resource and Benefit-Sharing”. The Agreement must establish, among other things, a fair and equitable share among the parties of benefits arising out of the economic exploitation of the product or process resulting from the access. The benefit-sharing may be made by the sharing of profits, the payment of royalties, the access and transfer of technology, the license, free of charge, of products and processes, among other means. In cases the Brazilian Government is not party to the Agreement, it shall also be entitled to

a part of said benefits. In order to be effective, the Agreement for Use of Genetic Resources and Benefit-Sharing must be submitted to the CGEN for approval and registration purposes.

The economic exploitation of products or processes developed from samples of any component of the Brazilian genetic resources or associated traditional knowledge accessed in violation of the provisions of the Provisional Act shall subject the infringer to the payment of damages corresponding to, at least, twenty percent of the gross revenues obtained in the commercialization of the relevant product or of the royalties obtained from third parties due to the licensing of the relevant product, process or use of the technology, in addition to the applicable administrative (the fine may reach R\$ 50 million) and penalties.

b) **Domain Names.** Domain names at the top level “.br” are granted by the Center of Information and Coordination (“NIC”), by delegation of the Managing Committee for Internet of the Ministries of Communication and Science and Technology

There are several top level domains corresponding to certain types of activity, such as “.com.br” for commercial purposes, “.ind.br” for industries, “.org.br” for nonprofit organizations, etc. The registration of “.br” domain names is conducted electronically.

Brazil adopts the “first-to-file” system. Therefore, apart from official names, offensive names and a very limited list of notorious trademarks, any combination of at most twenty-six words and numbers may be registered at the top-level domain name “br”. Any individual or entity may register an unlimited number of domain names at the same top-level domain. However, NIC sets forth additional requirements for foreign individuals or entities, such as the obligation of a foreign entity to initiate its activities and establish a local presence in Brazil within one year as of the registration of the domain name.

c) **Plant Varieties**

The protection of intellectual property rights related to plant varieties is accomplished by the granting of a Plant Variety Protection (“PVP”) Certificate. For purposes of legal protection, the plant variety must be a superior vegetable variety of any type or species, clearly distinguishable from other known plant

varieties by a minimum number of features, and must also have a distinguishing denomination and be homogeneous and stable with regard to its features throughout successive generations.

In order for a plant variety to be granted legal protection, it must be new or essentially derived from another variety.

The government agency responsible for the protection of plant varieties (National Service for Plant Varieties Protection - SNPC, of the Ministry of Agriculture and Supply) has gradually published the names of vegetable species and the minimum features necessary for an application for plant variety protection. The three (3) requisites with regard to applications for plant variety protection are as follows:

- (i) The plant variety has not been commercialized abroad in the last four (4) years.
- (ii) The plant variety has not been commercialized in Brazil in the previous year.
- (iii) The plant variety is distinctive, homogeneous and stable.

The PVP Certificate is valid for fifteen years, counted as of the date of granting of a provisional certificate of protection by the SNPC, except for vines, fruit trees, forest and ornamental trees, for which the term of protection shall be eighteen years. After the expiration of the Certificate's validity term, the variety's ownership will become public. The PVP Certificate provides protection against the unauthorized growing of the material, propagation of the variety for commercial purposes, as well as against marketing or offers for sale without the owner's authorization. However, such exclusive rights of the owner of the protected plant variety shall not be deemed infringed if one:

- (i) stocks or cultivates the seeds for his/her own use;
- (ii) uses or sells the product obtained from a variety as food or raw material (except for reproduction purposes);
- (iii) uses the variety as basis for variation in genetic improvements or scientific research studies; or
- (iv) is a small rural producer and multiplies seeds for donation or exchange, exclusively for other small rural producers, within the scope of financing or supporting programs for the benefit of small rural producers, conducted by public entities or nongovernment agencies authorized by the Public Administration.

d) Trade Secrets

In Brazil, the protection of trade secrets does not grant the owner proprietary rights over information involving the protection of trade secrets and prevention of the same from being disclosed, exploited or used without authorization.

This conduct may be characterized under Brazilian law as unfair competition.

The IP Law characterizes the unauthorized disclosure of a trade secret, exploitation or use as an unfair competition crime that entitles its legitimate holder to claim for losses and damages arising therefrom. Nevertheless, if a third party, by its own independent means, develops the same trade secret, it will also be its legitimate holder.

The nature of the information constituting a trade secret is not relevant for legal protection in Brazil, as the term “trade secret” is not defined by law. The information can be of technological, commercial, administrative, economic, fiscal or whatever nature, provided that it has economic value. Certain kinds of information cannot qualify as trade secrets, such as information obtained illegally by the owner, information of an unlawful nature, or information that is obvious to a person skilled in the art or that which is already public knowledge.

Trade secret protection is granted by the Brazilian Courts case by case. The central issue is usually the characterization of the disclosed information as a trade secret. For that purpose, the value of the information derives from its secrecy. Thus, the company’s internal policies on the handling and confidentiality of its relevant information are of utmost importance.

e) Genetically Modified Organisms

Brazil’s new Biosafety Law establishes a set of rules aimed at controlling the use of genetic engineering techniques for the development, breeding, handling, transportation, marketing, consumption, release and discharge of Genetically Modified Organisms (“GMOs”) into the environment, for the protection of human, animal and plant life and health, as well as the environment. (A GMO is any organism whose genetic material has been modified by any technique of genetic engineering.)

The Biosafety Law says that the release of any GMO into the environment shall be subject to a prior authorization from the Brazilian National Technical Biosafety Commission - CTNBio. Further to said authorization, any company willing to

develop activities in connection with biotechnology in Brazil, including research, development of technology and industrial production, must obtain a Certificate on Biosafety Quality and establish an Internal Committee for Biosafety (CIBio).

The importation of GMOs or products containing GMOs into Brazil is subject to the authorization of the Ministry of Agriculture which, in turn, depends on a technical opinion to be issued by the CTNBio. In order to import genetically modified vegetables or plants, the importer must also obtain from CTNBio a Certificate on Biosafety Quality and submit an import request to the Vegetal Inspection and Protection Department of the Ministry of Agriculture, detailing the exact quantity of such GMO's to be imported and the place in which research will take place. As soon as GMOs enter the country, these must be sent to the National Center of Genetic Resources and Biosafety for laboratory tests prior to the release thereof by the importer.

Additionally, some environmental licenses may be required, such as operation license, depending on CTNBio's expert opinion, which shall establish whether a GMO presents risks to the environment and, therefore, will be subject to environmental licensing.

[Revised as of September 2006]

Forms of Doing Business

As a general rule, Brazilian law does not prohibit or restrict the participation of foreign investment in business activities. Except for certain limitations, foreign investors are free to establish any business in Brazil.

Those few areas in which foreign investment is either totally prohibited or limited to a certain minority interest include some telecommunications services and media. In these restricted areas, foreign investors are required to enter into joint venture types of arrangements with Brazilian companies or individuals or organize a subsidiary company under the Brazilian laws. Foreign investors sometimes adopt joint venture arrangements even in situations that are not restricted – for instance, when they seek the experience and expertise of locals in the domestic market.

A business presence in Brazil may, at least in principle, take the form of either (a) a branch, representative office or agency of a foreign business entity, or (b) a company organized under the laws of Brazil.

Branch, Representative Office or Agency of Foreign Business Entity

Though permits to establish branches of companies organized under the Brazilian laws are freely granted, the prior authorization of the President of Brazil is required to establish a branch of a foreign company. The granting process is entirely discretionary and lengthy (lasting more than six months). In addition, adverse liability and tax consequences render this choice inappropriate in most cases.

Local Business Entity

The establishment of a business entity in Brazil generally does not require any prior government approval. Most nonresident investors have found it advisable to organize a business by setting up any of the following:

- (a) corporation - *sociedade anônima* (“S.A.”) in which liability is limited to the amount of the capital invested; and

- (b) *sociedade limitada* (“limitada”) which may be a more flexible form of a limited liability company, where the liability is limited to the total amount of the company’s capital.

The basic requirements of an S.A. are as follows:

1. Shareholders

There must be at least two; no residency or nationality requirement applies.

2. Capital

At least ten percent (10%) of the stated capital must be paid in with cash at the time of incorporation. No minimum is required except to carry out certain regulated activities, e.g., banking, insurance and trading companies. The capital of an S.A. is divided into shares. According to the rights attributed to their holders, the shares may also be qualified as common or preferred.

The number of preferred shares without the right to vote or with restrictions on the exercise of such a right shall not exceed 50% of the total number of shares issued by the S.A. Per legal provisions of the S.A., holders of preferred shares may not have voting rights, or they may have their voting rights restricted. However, the holders of preferred shares with no or restricted voting rights are entitled to certain financial rights, such as the priority

- (i) to receive dividends;
- (ii) to receive the reimbursement of capital, with or without bonus; or
- (iii) the accumulation of these advantages.

For publicly held S.A. (*Sociedade Anônima de Capital Aberto*), the corporate legislation provides more protection rules for the minority shareholders of preferred shares.

3. Management

The S.A. must be managed by at least two officers (*diretores*) who must be residents in Brazil. The residency requirement among expatriates to be appointed as officers of an S.A. A Board of Directors (*conselho de administração*) is not compulsory, unless the S.A.:

- (a) trades its shares in the stock exchange or in the over-the-counter markets;
- (b) issues debentures in the market; or
- (c) has an authorized capital.

Brazilian residence is not a requirement to assume the position of a member of the Board of Directors, provided that an attorney-in-fact resident in Brazil is appointed and vested with powers to receive services of process on behalf of a nonresident Director. Under the law, the Board of Directors must have at least three members who are holders of at least one share each.

4. Audit

The bylaws of the S.A. must provide for a shareholders' auditing committee (*conselho fiscal*), which may be installed at a shareholders' meeting. If the auditing committee is so installed, its annual report to the shareholders must be published together with the financial statements of the S.A., except if the conditions mentioned in the following item are complied with as well as in other specific cases.

5. Meetings and publications

Shareholders' meetings must be held annually (i.e., to approve the financial statements) within the first four months after the end of the company's corporate year. Calls for meetings must be published unless all shareholders attend or are represented at the meeting.

The minutes of the meetings shall also be published. Special meetings (such as those that are called to amend the bylaws) shall follow the same procedure. Balance sheets and financial statements must be published. Closely held S.A. (*Sociedade Anônima de Capital Fechado*) with less than twenty (20) shareholders and with a net worth of up to R\$1,000,000.00 (one million Reais) are not required to publish their financial statements, balance sheets, auditing committee's annual

reports and certain other information, provided that certified copies thereof are filed with the competent Commercial Registry together with the minutes of the general meeting containing the decisions thereon.

The Brazilian Civil Code (effective as of January 11, 2003) has introduced significant changes in the corporate legislation, especially in connection with the *limitadas*. The *limitadas* lost some of their main advantages, as to simplicity of organization and flexibility granted to the quotaholders to structure the company according to their needs. The Civil Code grants to minority quotaholders more rights, including new quorum to amend the articles of organization (3/4 of the corporate capital) and to appoint administrators, with rules stricter than those provided for the S.A's.

The basic characteristics of a *limitada* (*sociedade limitada*) are as follows:

1. Quotaholders

There must be at least two; no residency or nationality requirements apply.

2. Capital

No minimum capital is required either upon organization or to carry out business, except for specific activities. The *limitada* is not qualified to carry out certain regulated activities such as banking and insurance. The capital of a *limitada* is divided into quotas that are represented in the articles of organization of the *limitada*. The capital may be increased only after all subscribed-for quotas have been paid in.

3. Management

The *limitada* may be managed by the quotaholders themselves, if residents and individuals, or by one or more officers appointed by the quotaholders. Nonresident and legal entity quotaholders must appoint Brazilian resident individuals to represent them locally. If the articles of organization authorize the management of the company by third parties (not quotaholders), their appointment is subject to the approval of

- (i) all quotaholders, if the quotas are not fully paid in or
- (ii) quotaholders representing 2/3 of the corporate capital if the quotas are fully paid in.

If the officer is a quotaholder, his/her appointment within the articles of organization is subject to the approval of at least 3/4 of the company's capital, and, if made in a separate document, to the approval thereof by quotaholders representing (?) more than half of the company's capital.

(Regarding the appointment of expatriates for managing positions, please refer to the chapter on immigration.)

4. Audit

Audit is not required. However, the Civil Code authorizes the installation of an Audit Committee (*conselho fiscal*) composed of at least three (3) members.

5. Meetings and publications

The Civil Code sets forth that the quotaholders' decision shall be taken in a meeting or assembly, as provided in the articles of organization. The quotaholders' assembly is required if the company has more than 10 quotaholders and a quotaholders' meeting is required for companies with up to 10 quotaholders.

The Brazilian Federal Revenue Department issued the Normative Rulings No. 312, dated March 28, 2003, No. 200, dated September 13, 2002 and No. 190, dated August 9, 2002, according to which legal entities and individuals domiciled outside Brazil must be enrolled with the Ministry of Finance's General Taxpayers' Registry ("CNPJ") and Individuals Taxpayers' Registry ("CPF"), respectively.

This new requirement is applicable to all legal entities and individuals holding assets and rights subject to public registration in Brazil, including: real estate, vehicles, vessels, aircraft, equity interest in Brazilian companies, bank accounts, investments in the financial market, investments in the capital market, sale of intangible assets to Brazilian residents with a payment term lasting more than 360 days, loans ("financings"), import finance transactions, financial lease, operational lease, lease/renting out of equipment and boat charter, import of assets into Brazil (without currency exchange coverage) for equity investment in Brazilian companies and currency loans granted to Brazilian residents.

[Revised as of September 2006]

Exchange Controls

Until March 14, 2005, the Brazilian exchange market was divided into two segments: the Free Rate Exchange Market (also known as Commercial Market) and the Floating Rate Exchange Market (also known as Tourism Market).

In its bid to make the rules applicable to the control of the exchange market in Brazil more flexible, the National Monetary Council (CMN) has decided to unify both exchange markets by extinguishing the formerly existing exchange markets and creating the so-called New Exchange Market, with innovations so long expected on the rules for inflow and outflow of foreign currency. The New Exchange Market was launched by CMN's Ruling 3,265, enacted on March 4, 2005, and enforceable as of March 14, 2005.

On August 3, 2006, a few additional steps were taken to make foreign exchange rules more flexible. The Cabinet of the Presidency of Brazil enacted Provisional Measure 315 (MP 315), implementing, among other things, changes regarding the registration of foreign investment and import and export payments.¹

It is worth mentioning that despite these changes, the laws that deal with the foreign capital in Brazil and also with the exchange infractions have not been revoked and remain valid. Therefore, they still shall be observed and obeyed.

Foreign Capital in Brazil

Law No. 4,131/1962, as amended, regulates foreign capital in Brazil. This law requires that foreign investments must be registered with the Central Bank of Brazil ("Central Bank") to entitle the foreign investor to remit overseas dividends, interest on equity (*juros sobre capital próprio*) and funds related to repatriations of capital. The law establishes broad rules governing the reinvestment of profits and the payment of royalties and technical assistance fees.

¹ It is important to outline that, although the MP 315 has the same effects as those of a Brazilian law, it may lose its efficiency as of its issuance if it is not converted into a law by the Brazilian Congress (*Congresso Nacional*) within 60 days counted as of its publication, with the possibility to postpone such term for an equal period.

Investments

Foreign investments under the law include:

1. items imported as capital contributions (e.g., machinery, equipment);
2. capitalization of foreign credits which are remittable by Brazilian companies abroad; and
3. the inflow of foreign funds to Brazil as capital contributions.

As a general rule, a foreign investor may freely organize a subsidiary in Brazil to carry out any kind of business permitted by law, except for areas such as media, oil and gas, domestic vessel transportation, and air transportation in which foreign ownership is limited. Certain rules also restrict foreigners as to the area and scope of rural land they may own.

Restrictions to foreign ownership of media companies were reduced by Constitutional Amendment No. 36 of May 28, 2002 which authorizes, under certain conditions, the participation of foreign companies in up to 30% of the total and voting capital of companies engaged in newspaper publishing and radio broadcasting, sound and image production.

Registration of Investments in Foreign Currency

The foreign investment registration is carried out through the Central Bank's computer system ("SISBACEN") by means of the declaratory electronic registration (the so-called RDE-IED "*Registro Declaratório Eletrônico de Investimentos Externos Diretos*"). After the foreign currency funds are exchanged into local currency or the machinery is imported, as the case may be, the Brazilian beneficiary company must register the investment electronically with the Central Bank (both, in foreign currency and in the corresponding amount in local currency). This registration will be the vehicle for the remittance of dividends and interest on equity to the foreign investor, for obtaining additional registration upon the reinvestment of profits and for the repatriation of the foreign investment.

One of the changes brought by MP 315 includes the obligation of registering foreign investments in companies whose headquarters are located in Brazil and

evidenced in their accounting records, but which have not been duly registered with the Central Bank. This provision benefits those foreign investors who, for various reasons, can not have their investments duly registered with Central Bank and, consequently, have not been able to remit dividends allocated to the tainted portion of equity, or even repatriate their capital proportionally. It is important to highlight that, up to the date this text was reviewed, this provision was still pending CMN's regulation on how the registration of the foreign investment currently not registered will be implemented.

Registration of Investments in Brazilian Currency

Foreign investments made in Brazilian currency are also subject to registration with the Central Bank provided that the relevant funds arise from a bank account maintained in Brazil by the foreign investor, and provided that its implementation follows the regulations in force. The procedure for the registration of such investment is the same as that described above, except that the investment is registered only in local currency.

Conversion of Credits

The foreign capital registration may also be obtained upon the conversion of credits held by the foreign stockholder against its Brazilian subsidiary. Credits remittable abroad, such as those related to principal or interest of loans, service fees, royalties, among other things, can be converted into equity of the Brazilian company. For this purpose, a conversion process will be carried out, involving the implementation of symbolic exchange transactions representing the payment of the debt and the inflow of the corresponding funds to Brazil as capital contribution. The symbolic payment of the debt is taxed by the Contribution on Debt from a Bank Account ("CPMF") at a 0.38% rate and payments subject to withholding income tax shall also be taxed at the time the credits are converted.

Reinvestments

After profits are taxed, if they are not remitted abroad to the foreign investor, they may be reinvested in the same company that generates the profits or in any

other Brazilian company chosen by the foreign investor. The reinvestment is also registered electronically with the Central Bank and, as a general rule, in the currency of the investor's country.

To determine the amount of foreign currency to be registered as reinvestment, the Central Bank applies to the profits in Brazilian currency the average of the exchange rates verified on the date of the corporate document.

Remittance of Dividends

Law 4,131 of 1962, as amended, does not restrict a Brazilian company from remitting abroad the amount of dividends declared to the foreign investor. Under Brazilian law, to be able to remit dividends to a nonresident, the Brazilian company must, in addition to showing accounting profits in its financial statements, have its foreign investments duly registered with the Central Bank.

Interest on Equity (*Juros sobre Capital Próprio*)

Law No. 9,249/95 introduced a new concept in Brazil establishing that a Brazilian legal entity can pay interest on equity to its stock holders, provided that the company has retained or current-year earnings and that the foreign investments made in the Brazilian company are duly registered with Central Bank. The amount declared as interest on equity is treated by the tax rules as an operational deductible expense for the company declaring the interest on equity. Income tax at the rate of 15 % is withheld on the interest on equity declared in a stockholder's meeting. In case the beneficiary stockholder is located in a low-tax jurisdiction, the withholding income tax shall apply at a rate of 25%.

Repatriation of Capital

When the foreign investor sells shares or quotas in the Brazilian venture or when the Brazilian company reduces its capital or is liquidated, the foreign-registered investment can be repatriated in the relevant foreign currency free of taxes up to the amount of foreign currency registered with the Central Bank.

If the foreign investor withdraws from its Brazilian subsidiary by assigning its quotas/shares for an amount exceeding that registered with the Central Bank, the

exceeding amount is considered a capital gain and shall be subject to withholding income tax. Nevertheless, the exceeding amount may be remitted abroad in case of a local sale. Remittances of sale prices exceeding the net worth value (“*valor patrimonial*”) of the Brazilian company sold must be supported by an appraisal report. There is also a discussion on whether the calculation of the capital gain should be made taking into consideration the basis in Brazilian currency acquired by the foreign investor by the time the foreign investment was made, indexed by monetary correction until 1996.

Investments in the capital market

The Brazilian legislation allows the investment in the capital markets by individuals, legal entities, funds or other collective investment entities, with residence, head office or domicile abroad. These foreign investments, designated “portfolio investments”, are subject to registration with the Brazilian Central Bank and with the Brazilian Securities Commissions (“CVM”).

Prior to commencing their transactions, the foreign investors must appoint one or more attorneys-in-fact in Brazil, who will be responsible for providing information and complying with registration requirements of the Brazilian Central Bank and the CVM.

The foreign investor must be registered with CVM. Such registration may be implemented electronically, by the foreign investor’s attorney-in-fact. Additionally, the amounts invested in Brazil as “investment in portfolio” are subject to registration with the Central Bank, through the SISBACEN, by means of the so-called RDE-Portfolio (“*Registro Declaratório Eletrônico de Investimentos Externos nos Mercados Financeiros e de Capitais*”).

As regards the remittances abroad resulting from income, repatriation and capital gain, the intervenient bank is responsible for the analysis of the documents to be submitted, which must evidence the income distribution, the property and the sale of assets that generated them, as well as the withholding of due taxes.

In accordance and subject to the applicable legislation, the investments in the Brazilian stock exchange market are subject to a tax special regime, save certain exceptions.

Loans

Foreign loans (either in foreign or Brazilian currency) are subject to registration with the Central Bank. Such registration must be obtained through a declaratory electronic registration system (the Registration of Financial Operations – “ROF”), which will be carried out in the SISBACEN. The ROF must set forth the main financial terms and conditions of the loan, and interest charged on the loan may not be deemed excessive according to Central Bank’s policies in force at the time. Once the ROF is issued, the foreign lender is authorized to wire the foreign funds to Brazil. The Central Bank has 5 (five) business days to approve the loan conditions. Currently, the repayment of the loan principal is not taxed, unless the repayment occurs within 90 days, in which case it will be subject to Tax on Financial Transactions (IOF) at a current rate of 5%. Additionally, withholding income tax is levied to the payment of interests and fees associated to the loan at the standard rate of 15% (the 25% rate applies whenever the lender is based at the headquarters covered by a lower tax jurisdiction). Foreign government banking entities such as multilateral agencies in general enjoy special tax treatment.

Loans in Brazilian Currency

The loans in Brazilian currency are carried out through the International Transfer of Reais (“ITR”) and the inflows and outflows of funds related to loans in Brazilian currency shall be made through a nonresident bank account (the so-called CC5) held by the foreign creditor with a Brazilian bank.

Furthermore, according to the Central Bank’s Circular No. 3,027, loans in Brazilian currency must be registered with the SISBACEN through the Registration of Financial Operation - ROF.

An innovation introduced by Central Bank’s Ruling 3,265 is the possibility of payment in foreign currency of obligations denominated in Brazilian currency through the New Exchange Market, provided that certain requirements are met. Therefore, the Brazilian debtor of a loan denominated in local currency may remit the relevant payment to the creditor abroad, in the corresponding amount in foreign currency, instead of depositing the amount in local currency in the foreign creditor’s bank account maintained in Brazil.

Loans extended by Brazilian entities to foreign entities

Another innovation introduced by Central Bank's Ruling 3,265 is the possibility that a Brazilian entity will extend a loan in foreign currency to a foreign entity. Currently, Central Bank's prior approval is not necessary to implement this loan transaction or to process the remittances of funds from or to Brazil².

To implement this transaction, the parties shall execute an agreement setting forth the terms and conditions of the loan and the tax rules applicable thereto (including but not limited to potential transfer pricing issues) shall be observed.

Export Financing

The Brazilian government grants favorable treatment for Brazilian exporters to obtain foreign currency credit abroad as a way to increase exports. Interests and fee payments associated with financings obtained to finance exports are subject to a withholding income tax of 0% (zero percent) as opposed to the standard rate of 15% levied to regular loans interests (and the greater rate of 25% applicable to loans from lower tax jurisdictions). The export financings that are benefited with the zero percent tax rate must be repaid with export revenues on the maturity dates of the financing. The registration of the export financing is similar to the registration of the loans in foreign currency described above. It should be noted, however, that if the funds are not repaid with the exports revenues, the withholding income tax applied to the payment of interest and fees associated with the export financing will no longer be zero percent but 25%.

For companies focusing on exports, export financing which is well projected and coordinated in order to avoid the penalties for not meeting the conditions, is a good and cheap mechanism to fund the companies' operations.

² Notwithstanding, Central Bank's current rules provide that individuals and legal entities resident, domiciled or headquartered in Brazil must prepare and submit to the Central Bank a list of the assets and rights they hold outside of Brazil. (Please refer to the item "Declaration of assets maintained outside of Brazil" below.)

Importation of products

The Central Bank often changes the regulation related to importation of goods/equipment. Currently, import transactions, financial lease and leasing (rental) of equipment with payment terms exceeding 360 days must be registered with the Central Bank through the ROF system.

Before MP 315 was enacted, importers who failed to pay their imports within 180 days counted as from the first date of the month subsequent to the import's maturity date was subject to a fine of 0.5% over the outstanding import amount. The MP 315 stopped imposing the fine for imports with payment terms as of August 4, 2006 and those that on August 4, 2006 were not due for more than 180 days.

Exports of products and services

Pursuant to Brazilian export and exchange control regulations, exports must be carried out with exchange coverage (i.e., actual payment to the Brazilian exporter). The applicable regulations list very few exceptions in which the export may be carried out without exchange coverage (i.e., without payment to the Brazilian exporter), such as capital contribution and temporary export regime.

MP 315, however, has brought an important flexibilization to the above-mentioned exchange coverage requirement, authorizing the Brazilian exporter to maintain abroad foreign funds received as payments for its products and services exported. Such funds may be used by the Brazilian exporter only to carry out investments, financial investments or payments of its own obligations. The exporter is not allowed to lend such funds.

Per Resolution 3,389 enacted by the Brazilian Monetary Council ("CMN") on August 4, 2006, Brazilian exporters may maintain abroad up to 30% of the export payments. This prerogative applies also to the export registries made in SISCOMEX and to the services rendered to foreign residents up to 210 days before the Resolution 3,389 which took effect on January 9 this year). Such 30% limit may be altered any time by the CMN.

The destination of these funds shall be reported by the exporter to the Brazilian Federal Revenue Department. The exporters that do not follow the rules applied

to the maintenance of such funds abroad and to their use, or that fail to inform the Brazilian Federal Revenue Department about the existence of these funds, will be subject to a penalty to be imposed by said Department.

The Provisional Tax on Banking Transfer (“CPMF”), currently at the rate of 0.38%, will not be levied on the 30% amount maintained abroad.

The MP 315 must still be regulated by the tax authorities. Up to the date this document was reviewed, the tax authorities had not yet enacted the rules.

Declaration of assets maintained outside of Brazil

CMN’s Ruling 2,911/01 provides that individuals and legal entities resident, domiciled or headquartered in Brazil must prepare and submit to the Central Bank a list of the assets and rights they hold outside of Brazil, whose total amount is equal to or higher than a certain amount annually established by the Central Bank³. This declaration must be submitted to the Central Bank on an annual basis. The following assets held abroad must be reported to the Central Bank:

1. bank deposits;
2. loans;
3. financing transactions;
4. leasing;
5. direct investments;
6. portfolio investments;
7. financial derivatives investments; and
8. other investments, including real estate and other assets.

[Revised as of September 2006]

³ For the year ending December 31,2005, the minimum amount was US\$100,000.00 (per Central Bank’s Circular 3,313/06).

Taxes

Tax Treaties

To provide relief from double taxation on international transactions, Brazil has executed numerous tax treaties with other countries. The tax treaties provide for tax reductions on income such as royalties, interest, remuneration, dividends and profits. To date, Brazil has executed treaties with Argentina, Austria, Belgium, Canada, China, Chile, Czech Republic and Slovakia Republic, Denmark, Ecuador, Finland, France, Hungary, India, Israel, Italy, Japan, Korea, Luxembourg, the Netherlands, Norway, the Philippines, Portugal, Spain, Sweden, Paraguay*, Mexico* and Ukraine.

** Pending publication of the Executive Decree.*

Local Taxation

Historically, Brazilian tax regulations have remained complex. Although the government is engaged in reducing and simplifying the Brazilian taxation system, at this time, an extensive body of tax regulations still applies. This section summarizes the most significant taxes that affect businesses in Brazil, as well as the major aspects of Brazilian taxation of personal income, which affect nonresidents, particularly expatriates.

Corporate Income Taxes

Most business entities are required to pay corporate income taxes (IRPJ). The IRPJ is computed at fifteen percent (15%) rate on adjusted net income. Annual net income in excess of R\$240,000.00 is also subject to a surtax of ten percent (10%).

According to Law No. 9,430, of December 30, 1996, taxpayers may opt to calculate the IRPJ on a quarter or annual basis. If the IRPJ is calculated quarterly, it is also payable on a quarterly basis. Over the quarter net income, a fifteen percent (15%) rate is applied, plus a ten percent (10%) surtax on net income exceeding R\$60,000.00 per quarter. If the IRPJ is calculated annually, taxpayers are required to anticipate monthly payments of IRPJ, calculated over estimated income. For most companies, the monthly estimated income corresponds to eight

percent (8%) of the total monthly gross revenues plus capital gains and other revenues and positive results incurred by the company. Such percentage ranges from 8% to 32%, depending on the activity performed by the taxpayer. Over this tax basis, the fifteen percent (15%) rate applies, plus the ten percent (10%) surtax on estimated income exceeding approximately R\$20,000.00 per month. When the annual method of calculation is adopted, with payment of monthly anticipations, at the end of the year, the entities must either pay or request reimbursement for the difference between the amount paid monthly and that calculated on annual income.

Another used method of calculating income tax is the presumed method. In this case, the income tax is calculated on a quarterly basis and for most activities, the tax basis corresponds to eight percent (8%) of gross revenues. There are other applicable rates to calculate presumed income related to certain specific activities (e.g., thirty-two percent [32%] for most service activities). Over the presumed income, income tax rates of fifteen percent (15%) and ten percent (10%) surtax levied on presumed income exceeding R\$60,000,00 per quarter are applied. If the presumed method of taxation is adopted, the taxpayer is not subject to any adjustment according to annual actual income.

Some requirements for eligibility to adopt the presumed method are:

1. revenues earned in the previous taxable year which must not exceed R\$48,000,000.00;
2. profits, capital gains or other earnings which cannot originate abroad (e.g., from export transactions), and
3. financial institutions or equivalent entities, as provided in Brazilian law, which are not eligible to adopt the presumed method of taxation;
4. companies which cannot have tax benefits under Brazilian tax laws (e.g., tax exemption or income tax reduction);
5. companies which cannot have paid the income tax calculated on a monthly and estimated basis, and
6. factoring companies not allowed to adopt the presumed method. Until 1998, companies directly owned by foreign entities were not eligible to adopt the presumed method. In 1999, this restriction was revoked.

Net operating losses (“NOLs”) generated in a given period can offset taxable income of the subsequent period, limited to thirty percent (30%) of taxable income (i.e., for each R\$ 1.00 of income, R\$0.70 must be subject to taxation, regardless of the existing amount of NOL). Tax losses may be carried forward, without statute of limitation.

Prior to 1996, any dividends and profits distributed to nonresidents were subject to a fifteen percent (15%) withholding income tax (IRRF), except for distribution to residents of Japan, in which a Brazilian tax treaty provides for a 12.5 percent rate.

According to Law No. 9249, of December 26, 1995, profits realized after January 1, 1996 are no longer subject to the IRRF when distributed. Profits and dividends realized prior to January 1, 1996 are still subject to the IRRF at the rates prevailing within the year the profits are generated.

Interest on Equity

Law No. 9,249/95 provides that a Brazilian legal entity can pay or credit its equity holders interest on equity, provided that the company has retained or current-year earnings. The total amount of interest that can be paid or credited must not exceed fifty percent (50%) of the company’s retained or current-year earnings. Basis for calculating the amount of interest on equity includes reserves in addition to contributed capital, but excludes fixed assets revaluation, special monetary correction of fixed assets, and real estate and intangible revaluation reserves.

The interest is based on the government-monitored long-term interest rate TJLP (*Taxa de Juros de Longo Prazo*), calculated on a pro rata basis. The expenses with interest on capital are considered operational deductible expenses for income tax and for social contribution on net income. A fifteen percent (15%) withholding income tax is levied on the amount of interest paid, accrued to the equity holders, or capitalized.

Withholding Income Tax on Payments Abroad

In general, payments made to nonresidents are subject to withholding income tax in Brazil. As a general rule, payments to nonresidents for services rendered to Brazilian residents and payments to nonresident individuals for work remuneration are subject to the general withholding income tax rate of twenty-five percent (25%).

The twenty-five percent (25%) rate for payment of services does not apply to interest on loans, and other types of payments, which are not classified as services, and are subject to specific legal provisions. For these types of payments, the lower withholding rate of fifteen percent (15%) is still in place.

After the new Contribution for the Intervention in the Economic Domain (“CIDE”) was created on January 1, 2002, Law No 10.332 reduced the income tax rate applicable to technical services, administrative assistance and other similar services that did not involve transfer of technology to fifteen percent (15%). In addition, the payments remitted abroad for these services will be subject to the ten percent (10%) CIDE.

Law No. 9,779, Article 8 has increased the previous withholding tax of zero or fifteen percent to twenty-five percent (15-25%) for all payments of income, with few exceptions, made to nonresidents in a low-tax jurisdiction. The Brazilian Federal Revenue Department has listed some locations considered to be low-tax jurisdictions for Brazilian tax purposes (Treasure Ruling No 188/02). These are American Samoa, American Virgin Islands, Andorra, Anguilla, Antigua, Aruba, Bahamas, Bahrain, Barbados, Barbuda, Belize, Bermuda Islands, British Virgin Islands, Campione D’Italia, Cayman Islands, Channel Islands (Alderney, Guernsey, Jersey, and Sark), Dominica, Cook Islands, Costa Rica, Cyprus, Djibouti, Saint Kitts & Nevis, Gibraltar, Grenada, Hong Kong, Isle of Man, Labuan, Lebanon, Liberia, Liechtenstein, Luxembourg (with respect to holding companies existing per Luxembourg Law of July 31, 1929), Macao, Madeira Islands, Maldives, Malta, Mauritius Islands, Marshall Islands, Monaco, Monserrat Islands, Nauru, the Netherlands Antilles, Niue Islands, Occidental Samoa, Oman, Panama, Santa Lucia, Saint Vincent & Grenadines, San Marino, Seychelles, Singapore, Tonga, Turks & Caicos Islands, United Arab Emirates and Vanuatu. Thus, for example, interest payable on loans to a low-tax jurisdiction is currently subject to the greater twenty-five percent (25%) withholding rate, unless there is legal provision regulating the withholding tax on the specific type of loan contracted.

Social Contribution Tax

Most entities are required to pay social contribution on net income (CSLL). This is a true corporate income tax surcharge, at the rate of nine percent (9%). The reason it is levied separately from the corporate income tax is that it is paid to the social security system, and not to the Federal Administration.

Tax basis for the CSLL is net income specifically adjusted for CSLL purposes. Similarly to the IRPJ, taxpayers may opt to calculate CSLL on a quarterly or annual basis. In the latter case, monthly payments must be made on an estimated basis. Law No. 9,316, of November 22, 1996, provides that the CSLL is no longer deductible from net income for purposes of calculating IRPJ.

The negative basis of CSLL (tax loss for CSLL purposes) can be used to offset taxable income from subsequent periods, although limited to thirty percent (30%) of taxable income. Similar to tax losses for IRPJ purposes, negative basis of CSLL may be used to offset future taxable income without statute of limitation.

Together with the maximum rate for IRPJ purposes, the overall income tax rate (i.e., Federal Income Tax plus Social Contribution on Net Income) is currently thirty-four percent (34%).

Contribution for Intervention in the Economic Domain (“CIDE”)

This is a contribution due by companies that own licenses for the use of rights, acquire technological knowledge, or are parties to agreements which involve transfer of technology and are executed with foreign residents. As of January 1, 2002, CIDE is also exacted by companies that render technical services, administrative assistance and other similar services that do not involve transfer of technology. The CIDE is levied on the total amounts paid, credited, delivered, used or remitted, in each month, to nonresident beneficiaries, as royalties of any kind and remuneration under the following agreements:

1. supply of technology;
2. technical assistance (technical assistance services and specialized technical services);

3. trademark license and assignment;
4. patent license and assignment; and
5. agreements for the rendering of technical services, administrative assistance and other similar services that do not involve transfer of technology.

The rate is ten percent (10%) of the amount paid, credited, delivered, used or remitted monthly to nonresident beneficiaries of the items listed in the preceding paragraph. The contribution is due by the last business day of the fortnight following the month the royalty or fee is paid, credited, delivered, used or remitted abroad.

Contribution for Intervention in the Economic Domain (“CIDE”) on Fuels

This contribution is levied on the importation and commercialization of certain types of fuel (oil, diesel, aviation kerosene and other types of kerosene, fuel oil, liquefied petroleum gas, including that derived from natural gas and from naphthenate and alcohol fuel) at fixed amounts in Reais.

The CIDE shall be paid by the producer, blender or importer of fuels. The Taxpayer is allowed to deduct the CIDE from the PIS and COFINS contributions levied on sale of fuels, subject to limits of deduction provided for in the applicable legislation. This contribution shall not be levied on the income derived from the exportation of the products mentioned above.

Contribution for the Development of the National Cinematography Industry (“CONDECINE”)

This contribution is levied on the exhibition, production, licensing and distribution of motion pictures and video phonographic works with commercial purposes (per market segments) and is calculated based on the length of the work at fixed amounts.

The CONDECINE is also levied at an eleven percent (11%) rate on amounts paid, credited, remitted, delivered or used by local agents to foreign producers as a result of the exploitation of audiovisual works in Brazil or their importation at a fixed price.

Federal Welfare Taxes

Two types of federal welfare taxes, PIS and COFINS, are due on monthly gross revenues of any kind, with a few exceptions established by tax legislation.

Laws Nos. 10,637/02 and 10,833/03 introduced a new system for calculating the PIS and COFINS, which shall apply to most companies in Brazil. The main purpose of this legislation is to avoid the cumulative effect of those contributions through the grant of tax credits. Therefore, currently PIS and COFINS levy on the company's gross revenues on a non-cumulative basis at the combined rate of 9.25% (PIS – 1.65% and COFINS – 7.6%).

According to the new system, the taxpayer is entitled to credits related to these contributions in the following operations:

1. acquisition of goods for resale;
2. acquisition of goods and services to be used as raw materials for manufacturing products for sale or used in the rendering of services;
3. acquisition of machinery and equipment to be used in the manufacturing process of products for sale, as well as in the acquisition of other goods incorporated to the fixed assets.

These credits can be used by the company to reduce the PIS and COFINS levied on revenues derived from subsequent transactions.

This new system does not apply to certain taxpayers such as: (i) companies that calculate the income tax based on the presumed or arbitrated profit; or (ii) financial institutions, health plans operators, private pension entities and security companies, among others. In these cases, the PIS and COFINS will continue to apply on the company's total revenues, in general at the combined rate of 3.65%. Financial institutions are subject to COFINS at a 4% rate and PIS at a 0.65%.

PIS/COFINS – Import

On April 30, 2004, the Brazilian Official Gazette published Law No. 10,865, which provided for the levy of the Federal Welfare Taxes, PIS and COFINS on the importation of goods and services (“PIS/COFINS – Importação”).

PIS and COFINS – Import levy will be imposed on goods and services, as a general rule, at a total rate of 9.25%.

These contributions will be exacted on the total value of the imported goods including State Value-added Tax (“ICMS”) and these contributions (PIS and COFINS). In cases of importation of services, the contributions will be exacted on the amount paid, credited, delivered, used or remitted abroad, calculated before the Withholding Income Tax, plus the Municipal Services Tax (“ISS”), including PIS and COFINS.

Legal entities subject to the rules of non-cumulative PIS and COFINS, pursuant to Laws No. 10,637/02 and 10,833/03, are allowed to take credits derived from the PIS and COFINS levied on the importation of goods or services, according to specific conditions established by legislation and as mentioned in the item related to the federal welfare taxes.

Import Duty

An import duty (II) is due upon customs clearance of imported products on an *ad valorem* basis. The rate varies, depending on the tariff classification of the product imported. Imports are also subject to the IPI and ICMS (as described below). These taxes, along with II, are calculated as follows: the II is levied on the CIF value of the imported product; the IPI is levied on the CIF value plus II; and the ICMS is levied on the CIF value plus II, IPI and ICMS itself.

Export Tax

An export tax (IE) is due at the time of export. The tax applies on an *ad valorem* basis to a limited list of products. The tax rate varies, depending on the type of product exported.

Excise Tax

The Federal Excise Tax (IPI) is a federal value-added tax levied on industrialized products as they leave the plant where they are manufactured. The IPI is also due on imported industrialized products, upon importation and resale by the importer. IPI rates may vary depending on whether the type of product is regarded as essential or not.

The IPI is levied at each production stage of manufactured products and on the import of manufactured products. This tax is paid on the acquisition or importation of raw materials and intermediate products, parts, components, and the like, and can offset the IPI due on subsequent transactions. The net effect is a tax on the value added at each stage of production.

Financial Transactions Tax

A financial transactions tax (IOF) is imposed on foreign currency exchange transactions effected to remit payments abroad for services, including technical assistance fees and royalties for the use of trademarks and patents. The local party who remits the funds abroad bears the responsibility of paying the IOF. The tax is collected by the commercial bank in Brazil at the time of the transaction.

Currently, however, a zero rate applies to most cases.

The IOF is also due on currency exchange transactions intended to extend loans to Brazilian residents and/or to make certain investments in Brazil. Currently, the IOF rate is five percent (5%) on loans extended to Brazilian entities with a maturity term of less than 90 days. The law establishes a limit of 25 percent for increase of this tax. On exchange transactions made by a credit card administrator in order to cover expenses made by their clients abroad, the applicable rate is two percent (2%).

In addition to currency exchange transactions, an IOF is applied to financial transactions involving credit, insurance and securities.

Provisional Tax on Banking Transfer (Contribuição Provisória sobre Movimentação ou Transmissão de Valores e de Créditos de Natureza Financeira - “CPMF”)

Law No. 9,311, of October 24, 1996, created the CPMF tax under temporary application. In 2003, the effects of this tax were extended until December 2007. The CPMF applies at a 0,38% rate to all banking transfers and withdrawals of currency, such as the cashing of checks.

Investment Account

On April 2, 2004, the Official Gazette published Provisional Measure No. 179 amending the legislation of the Provisional Tax on Banking Transfers (“CPMF”)⁴. Provisional Measure No. 179 was converted into Law No. 10,892 of July 13, 2004.

Law No. 10,892/04 which took effect on October 1, 2004 provides that all financial institutions shall offer investment accounts to its clients. Investment accounts are bank accounts established and utilized by taxpayers for the sole purpose of making financial investments (fixed or variable income investments). The CPMF tax rate applicable to transfers between investment accounts and investment funds will be reduced to 0%.

The practical effect of an investment account is to eliminate the cost of CPMF for migration between investments. Only the transfer of funds from the investor’s regular bank account to its investment account will be subject to CPMF. Transfers between the investment account and different investments and redemptions of investments into the investment account will not be subject to CPMF.

Law 10.892/04 also establishes a specific rule for the movement of funds invested on or before September 30, 2004. It provides that the investments shall be directly transferred to the regular bank account and then into the investment account for migration to other investments; alternatively, taxpayers under these conditions may wait until October 1, 2006 to enable them to use the investment account without having to pay CPMF.

State Value-added Tax on Sales and Services (ICMS)

Similar to the IPI, the ICMS is another value-added tax on sales and services, payable upon importation of a product into Brazil and sale or transfer within Brazil, or as to certain communication and intra and interstate transportation services, at the time the service is rendered.

ICMS rates and tax benefits vary from state to state and depend on the type of transaction (e.g., intra or interstate sale of goods, communication or transportation services, etc.). Currently, ordinary rates in the State of São Paulo

⁴ The Provisional Tax on Banking Transfers was introduced by Law No. 9,311 of October 24, 1996.

are twelve percent (12%) on transportation services, eighteen percent (18%) on products imported, sold or transferred, and twenty-five percent (25%) on communication services. According to Constitutional Amendment No. 33/01, the ICMS shall be levied on importation carried out by legal entities as well as by individuals, even if they are not considered taxpayers for ICMS purposes, at an eighteen percent (18%) rate. Other rates may also apply, according to the specific product or service. Rates may also vary with respect to interstate transactions, normally seven percent (7%) or twelve percent (12%) depending on the state of destiny of goods and services.

Similar to the IPI and to the VAT existing in most European jurisdictions, the ICMS system permits a given taxpayer to offset the ICMS paid in acquired goods and services against the ICMS due on subsequent taxable transactions (e.g., sale of goods and services subject to ICMS tax). The difference is the amount due the State government.

Since November 1, 1996, importers/purchasers may take a credit for the ICMS paid on imports and local purchases of fixed assets (which were not permitted until November 1, 1996). Nevertheless, Complementary Law No. 102/00 has introduced a new system for the appropriation of the ICMS credits upon the acquisition of fixed assets, so that the taxpayer is allowed to register the mentioned credits at a monthly rate of 1/48. As of January 1, 2007, the taxpayer will be allowed to take a credit for the ICMS paid on acquiring goods (other than raw material, intermediate products and packaging material) self-consumed in the taxpayer's activities.

For taxpayers with excess of ICMS credits, some State regulations provide for alternatives that permit the taxpayer to transfer such credits. In the State of São Paulo, for example, State regulations provide some alternatives through which the taxpayer with excess of ICMS credits can use the tax already paid (besides offsetting ICMS debits). They can (i) transfer ICMS credits to any of its branches or offices located within the State of São Paulo; (ii) transfer the credits to an interdependent company, as defined in the regulations; or (iii) use the credits to pay the purchases to a supplier of raw material or and certain fixed assets. Other State regulations may provide for other alternatives to use excess ICMS credits.

Tax on Transmission of Assets by Donation or Mortis Causa (ITCMD)

The ITCMD is a state tax that is levied on the transmission of movable or immovable assets as a result of donation or in the event of the death of the owner. Currently in the State of São Paulo, the ITCMD levies at a four percent (4%) rate on the appraised value of the movable asset, real estate or transmitted rights.

Municipal Services Tax

Federal regulations list specific services to which a municipal services tax (ISS) applies. Rates vary from 2 to five percent (2-5%), depending on the type of service and the particular municipality in which the party rendering the services is located.

On July 31, 2003, Brazilian government enacted Complementary Law No. 116, introducing relevant changes in the legislation of the ISS.

Pursuant to the new legislation, ISS shall be levied not only on services rendered in Brazil, but also on “importation of services”, i.e., services originating overseas or those initiated abroad. In such cases, each Municipality may set forth in the relevant municipal law that the recipients or agents of the services in Brazil are responsible for collecting the tax due. Complementary Law No. 116 also sets forth that export of services abroad shall not be subject to ISS, except for services developed in Brazil whose results occur in Brazil, even if the payer is a foreign resident.

Additionally, Complementary Law No. 116 lists the services that shall be subject to the ISS taxation. The list includes several services that were not encompassed by the prior legislation, apart from certain services that were maintained, as an example, the assignment of trademark use and propaganda signals; assignment or license of use of computer programs; franchising; improvement, recondition and congenerous now extended to objects intended for industrialization or commercialization; maritime agency; installation and assembly of products, parts and equipment related to the execution of civil construction works, among other things.

Real Estate Property Tax

The real estate property tax (IPTU) is a municipal tax levied annually at progressive rates according to the appraised value and use of the real estate in the Municipality of São Paulo.

Real Estate Transfer Tax

The ITBI, also known as SISA, is a municipal tax on the transfer of real estate. The rates may vary according to the actual value of the transaction or the appraised value of the property, whichever is higher. In the Municipality of São Paulo, however, a fixed rate of two percent (2%) applies. The ITBI/SISA does not apply to real estate transfers pursuant to corporate mergers or contributions of paid-in capital.

Personal Income Taxation

Brazilian tax law distinguishes individual residents from nonresidents. Generally speaking, a Brazilian national is automatically a resident while legally domiciled in Brazil or, if not domiciled in Brazil, upon his or her election to be treated as a resident for tax purposes.

Payments for individual's work

As a general rule, payments for services from a Brazilian source to nonresident individuals may be subject to a twenty-five percent (25%) withholding tax rate.

Visas

Beginning January 1, 1999, temporary visa holders are considered residents for tax purposes from the moment they enter the country to work under an employment contract. Accordingly, they must deliver an annual tax return including their worldwide income and payments are subject to the progressive income tax at rates of fifteen percent (15%) or twenty-seven and half percent (27.5%) which is the maximum rate.

Also, holders of temporary visas entering the country for reasons other than those indicated in an employment contract are considered residents for tax purposes after 183 days of stay – that is, twelve months starting on the day of entry.

Nonresidents

Expatriates treated as nonresidents are subject to Brazilian income tax but only on income received from Brazilian sources, i.e., from Brazilian residents, whether individuals or legal entities. Brazilian source income from salaries and wages are subject to the standard 25% withholding income tax, while capital gains are subject to the 15% withholding income tax. This taxation may be reduced if a tax treaty is applicable. The tax is generally based on gross payments (i.e., without any deductions), and is due when the funds are credited, made available, used on behalf of, or effectively remitted to, the nonresident, whichever occurs first.

Residents

Brazilian residents are subject to Brazilian income tax on their worldwide income, at progressive rates, which vary depending on the specific bracket of their net overall taxable income. The current rates are as follows: fifteen percent (15%) for income between R\$ 1,257,13 and 2,512,08 per month, and twenty-seven and a half percent (27.5%) for income that exceeds R\$ 2,512.08. Nevertheless, under certain conditions and provided the expatriate's country grants reciprocity, resident expatriates are allowed to offset their Brazilian tax liability with federal taxes paid abroad on foreign-source income.

Transfer Pricing

As of January 1, 1997, Brazil has introduced specific transfer pricing rules (Articles 18 to 24 of Law No. 9,430) aimed at preventing undue allocation of income in international commercial transactions between related parties. The system adopted is one of determining the maximum amounts of deductible expenses, and minimum amount of taxable income, for Brazilian entities engaged in transactions with related parties outside of Brazil.

The transfer pricing rules provide for three methods to determine maximum deductible expenses, costs and charges related to goods, services or rights imported from a related party. The three methods are the following:

1. Comparable Uncontrolled Prices;
2. Resale Price Less Profits;
3. Production Cost Plus Profits.

For exports, taxpayers will be subject to adjustments whenever the average sales price in such transactions is lower than ninety percent (90%) of the average sales price in the Brazilian market during the same period and according to similar payment conditions. If the average price with related parties is less than ninety percent (90%) of that used with unrelated parties, the export income will be adjusted according to one of the following methods:

1. Average Price of Export Sales;
2. Wholesale Price in the Destination Country Less Profits;
3. Retail Price in the Destination Country Less Profits;
4. Acquisition or Production Cost Plus Taxes and Profits.

On April 30, 1997, transfer pricing regulations were issued through Treasury Ruling No. 38/97. In 2000, new provisions and regulations were issued dealing particularly with the Resale Price Less Profit method for imports of products subject to manufacturing processes in Brazil (Provisional Measure No. 1924 – converted into Law No. 9959/2000 and Treasury Ruling No. 113/2000). Note that, on November 11, 2002, Treasury Ruling No. 243 was promulgated and it introduced a new methodology for the calculation of the parameter price through the method “Resale Price Less Profits” at sixty percent (60%).

Treasury Ruling No. 243/02 did not bring additional changes to the methods and usual application of transfer pricing rules in Brazil, in comparison to the old Normative Rulings Nos. 38/97 and 32/01, but clarified some aspects that had been unclear so far. In any event, the taxpayer has the burden of proof to demonstrate compliance with transfer pricing rules; otherwise, the tax administration may start a case. The costs and average prices to which Law No.

9,430/96 refers must be based on either official information or reports from the importing or exporting country or research conducted by companies or institutions with notorious technical expertise.

For goods, services and rights imported from a related party, the taxpayer must prove that the corresponding costs, expenses and charges do not exceed at least one of the three methods set forth by Law No. 9,430/96. Otherwise, the tax authorities may challenge the exceeding deduction. The exceeding amount shall be added back as taxable income and will thus be subject to the corporate income tax at the rate of fifteen percent (15%) plus a surtax of ten percent (10%). The nine percent (9%) social contribution on adjusted income also applies on the exceeding amount.

Although Law No. 9,430/96 does not provide for adjustments to compare the taxpayer's prices with prices adopted by other Brazilian companies that import or sell identical or similar goods, services or rights in the Brazilian market, Treasury Ruling 243/02 establishes some guidelines for comparison purposes.

The regulations define "similar goods" as those that simultaneously:

1. have the same nature and the same function;
2. can mutually replace one another in the function for which they are made; and,
3. have equivalent specifications.

Related parties for transfer pricing purposes

The following are deemed a related party of the taxpayer for transfer pricing purposes:

1. its parent company, domiciled abroad;
2. its branch or agency, domiciled abroad;
3. the person or legal entity, resident or domiciled abroad, whose interest in the capital of the Brazilian taxpayer characterizes it as controlling shareholder or affiliate party, as defined in the Corporate Law;
4. the legal entity domiciled abroad that is characterized as a controlled entity or an affiliate party of the Brazilian taxpayer, as defined in the Corporate Law;

5. the legal entity domiciled abroad, when such an entity and the Brazilian taxpayer are under the common corporate or administrative control, or when at least ten percent (10%) of the capital of each entity is owned by the same person or legal entity;
6. the person or legal entity resident or domiciled abroad that, together with the Brazilian taxpayer, holds interest in the capital of a third legal entity, whose sum characterizes them as the latter's controlling shareholders or affiliate parties, as defined in the Corporate Law;
7. the person or legal entity, resident and domiciled abroad, that is associated in the form of a consortium or condominium, as defined by the Brazilian law, in any enterprise;
8. the person resident in Brazil who is a relative up to the third degree of consanguinity (as defined in the Brazilian Civil Code), the spouse or companion of the Brazilian company's management or direct or indirect controlling shareholder;
9. the person or legal entity, resident or domiciled abroad, who has exclusive rights, as agent or distributor, to purchase and sell goods, services and rights of the Brazilian entity;
10. the person or legal entity, resident or domiciled abroad, who has the Brazilian entity as exclusive agent or distributor to purchase or sell goods, services or rights.
11. taxpayers who need to reflect in their annual tax return ("DIPJ") the existence of any relationship with related individuals or legal entities domiciled abroad and who are also required to report transactions subject to transfer pricing rules.

Interposed party

The transfer pricing rules apply on transactions carried out by an entity domiciled in Brazil, through an interposed party ("third party") who is not considered a related party, to the extent that such interposed party deals with another party abroad who is considered a related party of the referred Brazilian entity.

Methods Applicable to Imports of Goods, Services or Rights

Comparable Uncontrolled Price Method

This method is defined as the arithmetical average of sales price of goods, services or rights, either identical or similar, prevailing in the Brazilian or foreign markets, on transactions of purchases and sales, under similar payment conditions. In other words, the taxpayer shall compare its costs, expenses and charges of goods, services or rights acquired from a related party, during a given period, with such arithmetical average. If the costs, expenses and charges incurred by the taxpayer exceed the arithmetical average, the exceeding amount shall then be added back as taxable income.

Although Law No. 9,430/96 is silent, Treasury Ruling No. 243/02 provides for some adjustments between controlled and uncontrolled prices. For identical goods, services and rights, Treasury Ruling No. 243/02 permits adjustments related to:

1. payment conditions;
2. quantities negotiated;
3. obligations related to warranty for the goods, services or rights;
4. obligations related to promotion of the goods, services or rights by means of marketing and advertising;
5. obligations for quality control, standard of services and health conditions;
6. agency costs in purchase and sale transactions carried out by unrelated parties;
7. packaging;
8. freight and insurance.

For similar goods, services or rights, besides the adjustments listed above, the regulations permit the taxpayer to make adjustments relating to physical differences between the goods, services or rights taken into consideration for comparison purposes.

Still with respect to the arithmetical average, only transactions carried out between unrelated purchasers and sellers will be taken into consideration for purposes to calculate such average. In addition, it is important to note that neither Law No. 9,430/96 nor Treasury Ruling No. 243/02 elects a preferred jurisdiction, whether local, state or foreign, in which “uncontrolled prices” are adopted in transactions between unrelated parties. Thus, a taxpayer may take into account, for purposes to calculate the arithmetical average price of goods, services or rights, “uncontrolled prices” adopted in either local, state or nationwide markets, or in import/export transactions, as well as in transactions carried on outside Brazilian territory.

Resale-Price-Less-Profit Method

Under the original rules and regulations enacted in late 1996 and in mid-1997, importers could not use the resale price method when imported goods or rights were subject to another manufacturing process that would result in a new product. In these cases, the importer had to use one of the two remaining methods – that is, the comparable uncontrolled price method or the cost-plus method.

On October 7, 1999, the President of Brazil issued Provisional Measure No. 1.924/99 (Law No. 9.959/2000) introducing some changes to Brazil’s transfer pricing rules. The most relevant change is the adoption of a new resale price method for imports of goods or rights that will be subject to another manufacturing process in the country. Under the new rules, there is a bifurcation of the resale-price-less-profit method, depending on whether the importer will submit or not the imported products to manufacturing process within Brazil.

For imported goods, services or rights to be subject to a further manufacturing process by the importer or a related entity, the resale-price-less-profit method is defined as the arithmetical average of resale prices of goods or rights (in Brazil) less:

1. Unconditional discounts granted;
2. Taxes and contributions imposed on sales; or commissions and brokerage fees paid;
3. A profit margin of sixty percent (60%), calculated over the resale price after deducting the above three items and the proportional value added in the country.

Normative Ruling No. 243/02 establishes the procedure to calculate the import cost of goods, services or rights used in the manufacturing process, pursuant to PRL. This Normative Ruling not only defines “parameter price” (*preço parâmetro*), but also requires that this price be calculated considering the percentage of the imported goods, services or rights in relation to the total cost of the manufactured product.

For goods, services or rights imported into the country and not subject to a manufacturing process locally, the old rules continue to apply. In this case, the resale-price-less-profit method is defined as the arithmetical average of resale prices of goods or rights (in Brazil) less:

1. Unconditional discounts granted;
2. Taxes and contributions imposed on sales;
3. Commissions and brokerage fees paid; and
4. A profit margin of twenty percent (20%), calculated over the resale price (after deducting unconditional discounts).

It is important to note, however, that when the 20 percent profit margin applies, the rules are silent as to any deduction from the resale price over which the profit margin is calculated. One could construe that no deduction from the resale price would be allowed to calculate the 20 percent margin (that is, that the margin would be calculated over the total resale price with no deduction whatsoever). However, the existing regulations, although based on the old rules, provide that the 20 percent margin should apply over the total resale price, less the unconditional discounts only. If the regulations are not changed in the future, unconditional discounts could be subtracted from resale price to calculate the 20 percent margin.

The resale price to be considered for purposes of this method is the price adopted by the taxpayer in the wholesale or retail markets with unrelated purchasers with either individuals or legal entities. Differences in payment conditions can be adjusted according to the interest rate adopted by the taxpayer in its regular sales. If the taxpayer does not adopt a specific interest rate consistently, the adjustments in payment conditions should be made according to interest rates provided for in the regulations.

The costs of freight and insurance borne by the Brazilian importer and also the unrecoverable taxes paid on imports (e.g., import duties) must be included to determine the cost of the goods under the Resale Price Less Profit method. The wording of the old regulations seemed to consider the inclusion of these costs as an option. The new regulations make clear that the inclusion is mandatory.

Finally, as regards the profit margins, the regulations accept profit margins other than those set forth in the specific methods, provided the taxpayer proves them based on publications, surveys or reports prepared by foreign governments, foreign tax authorities, or companies or institutes of **notorious** technical knowledge.

Production-Cost-Plus-Profits Method

The third method used to determine arm's length prices for imports of goods, services or rights is the production-cost-plus-profit method. It is defined as the average production cost of goods, services or rights, either identical or similar, in the country where they have been originally produced, and the taxes levied on exports in such a country and a markup of 20 per cent, calculated over the production cost.

According to the regulations, the following items can be computed in the (production) cost for purposes of this specific method:

1. Acquisition costs of raw materials, intermediary products and packaging material used in the production of the goods, services or rights;
2. The costs of other goods, services or rights used or consumed in the production of the relevant goods, services or rights;
3. The cost of the personnel used in the production of the goods, services or rights, including those for production supervision, maintenance and security of production facilities and corresponding social charges;
4. Costs of rents, leases, maintenance and repair, and depreciation and amortization charges of the goods, services or rights used in the production of the relevant goods, services or rights;
5. Reasonable losses in the production process, since admitted by the tax legislation in the foreign country.

Therefore, to determine the maximum deductible costs, expenses and charges according to this method, the taxpayer is required to prove he/she does not exceed the production cost, plus taxes and a twenty percent (20%) profit margin in the country the goods, services and rights have been produced. The profit margin of twenty percent (20%) applies over the production costs before the taxes levied on exports.

Methods applicable to exports of goods, services or rights

Average Price of Export Sales Method

The taxpayer must first show that the export price in a transaction with a related party is higher than ninety percent (90%) of the average sales price adopted in the Brazilian market with unrelated parties. Therefore, this is the first condition for the taxpayer to avoid allocation of income based on the methods set forth by the transfer pricing rules.

For this purpose, the sales price in the Brazilian market shall be considered net of unconditional discounts, ICMS tax, ISS tax and the social contributions of gross receipts (i.e., the PIS and the COFINS). The export price shall be considered net of insurance and freight expenses borne by the exporter.

In case the export price does not exceed ninety percent (90%) of the average sales price in the Brazilian market, the taxpayer is required to compute a taxable income equal to one of the four methods provided by transfer pricing rules.

The Average Price of Export Sales method is defined as the arithmetical average of export prices adopted by the taxpayer or another exporter of goods, services or rights, either identical or similar, with unrelated parties, during the same period of calculation of the corporate income tax and under similar payment conditions.

If the taxpayer does not export goods, services or rights to unrelated parties, the tax authorities may compare the taxpayer's export prices with those adopted by third parties that export identical or similar goods, services or rights. The concept of "similar goods" for exports is the same as that applied to imports.

If the taxpayer does not carry out sales activities in the Brazilian market either, the regulations allow taking into consideration sales prices adopted by third parties. In an extreme situation, the taxpayer may face allocation of income based on comparisons made with exports prices and sales prices in the Brazilian market both adopted by third parties.

Wholesale Price in the “Destination Country Less Profits” Method

The second method for exports carried out with a related party is the wholesale price in the “destination country less profit” method. It is defined as the arithmetical average of sales of goods, either identical or similar, adopted in the wholesale market in the country of destination, with similar payment conditions, after deducting

- (i) the taxes computed in the sales price, charged in such a country, and
- (ii) a profit margin of fifteen percent (15%) over the wholesale price.

Retail Price in the “Destination Country Less Profits” Method

This method is similar to the preceding method, except that it takes into consideration the retail price instead of the wholesale price. It is defined as the arithmetical average price of goods, either identical or similar, adopted in the retail market in the country of destination, with similar payment conditions, after deducting

- (i) the taxes computed in the sales price, charged in such a country, and
- (ii) a profit margin of thirty percent (30%) over the wholesale price.

Production-Cost-Plus-Profits Method

This is an authentic cost plus method. Such method requires the Brazilian seller to recognize, at least, a profit margin of fifteen percent (15%) plus the costs incurred for income tax purposes. It is defined as the arithmetical average acquisition or production costs of goods, services or rights exported, including the taxes levied on exports in Brazil and a profit margin of fifteen percent (15%) over the sum of costs and taxes. Pursuant to the regulations, the amounts paid by the foreign entity as freight and insurance shall be included to determine the acquisition costs for purposes of this method.

One of the relevant questions to be yet defined is whether services rendered by Brazilian service renderer within our territory, to a foreign related party, would in fact constitute (or not) an exportation under the transfer pricing rules, or whether the latter concepts/principles should only be applicable, for instance, to services rendered outside the Brazilian boundaries, representing, therefore, a clear and actual exportation.

Application for Lower Profit Margins

Treasury Ruling No. 32 also permits taxpayers to apply for a change of profit margins set forth in the transfer pricing regulations. The Regulations provide that this proceeding shall follow the general rules for Request for Rulings set forth in the current legislation.

To change profit margins, the taxpayer must file an application with the Treasury and provide certain documents. The Treasury Ruling also requires the taxpayer to indicate the term within which the new profit margin will be adopted. The reason is yet unclear, particularly because the taxpayer has the opportunity to change the current method to one of a better transfer pricing at the beginning of each fiscal year (January 1 in Brazil). As the application is filed, the Treasury analyzes the proposed profit margin, the term within which it will apply and the documents the taxpayer presents. The Ruling authorizes the Treasury to request further information and documents, if necessary.

The request for change in profit margins can now be supported by official reports and publications of foreign countries, studies and reports prepared by independent third parties with **notorious** technical expertise and also research studies prepared by the World Trade Organization (WTO) and the OECD. The former regulations allow the use of such reports, studies and research studies as an element of evidence, but not specifically as a support when applying for lower profit margins.

If the Treasury does not accept the profit margin proposed, it notifies the taxpayer thereof. No appeal is available. If the Treasury accepts the profit margin and the term, the application is sent to the Ministry of Finance which notifies the taxpayer by means of an Ordinance. If the Treasury accepts the profit margin but does not accept the term, it shall propose a new term that the taxpayer must follow. Again, no appeal is allowed.

Market Penetration

Transfer pricing regulations provide for special treatment when a Brazilian exporter will start selling its products in a new marketplace. In this case, the regulations permit an exporter to adopt sales prices less than ninety percent (90%) of the average sales price in the Brazilian market.

The Brazilian exporter, however, can only benefit from these special provisions if, in addition to a previously approved “exportation plan” presented to the Treasury, the exporter complies with certain legal conditions.

Intercompany Loans

Also in connection with transfer pricing, Law No. 9,430 sets forth the minimum (taxable) and maximum (deductible) interest rates charged in intercompany loans, which are not subject to registration with the jurisdiction of the Central Bank of Brazil: LIBOR for six months plus three percent (3%). Brazilian borrowers can only deduct a maximum interest rate of LIBOR plus three percent (3%) paid to a nonresident related party, while Brazilian lenders must recognize as taxable income, at least, the LIBOR plus three percent (3%) spread on loans extended to foreign related parties.

Normative Ruling No. 243/02 establishes that the provisions applicable to interests paid or credited to related parties resident abroad apply not only to loans, but also with respect to financial transactions in general. Pursuant to the ruling, the interest deductible from the corporate income tax and the social contribution basis may be calculated according to comparable agreements or pursuant to comparable financial transactions that have the same date, interest rates and terms.

“Safe harbors” (applicable to exports only)

Treasury Ruling No. 243/02 sets forth two unclear provisions, which some have interpreted as “safe harbor” situations. The first case provides that the taxpayer that has a net profit originating from export sales to related parties, before income tax and the nine percent (9%) social contribution on adjusted income and, of at least five percent (5%) over such sales, can demonstrate its compliance with the transfer pricing rules only with the documents of the relevant transactions with related parties. The minimum 5% net profit over the export sales must be

calculated based on the annual average of the current year and the two precedent years. Although this rule is not clear on how this annual average must be calculated, the most conservative interpretation is that the annual average must be calculated for each year. In this case, the taxpayer must register profits in the current year and in each one in the past two years.

In addition, according to the Normative Ruling No. 321/03, the calculation of this safe harbor cannot encompass sales transactions regarding rights, goods or services whose profit margin has been changed, in accordance with Articles 32, 33 and 34 of Normative Ruling No. 243/02.

The second case provides for the same consequence when the taxpayer shows net export revenues originating from controlled transactions equal or less than five percent (5%) of its total net revenues. Such situations cannot be characterized as true “safe harbors”, particularly because the tax authorities have the power not to accept the amount of revenues recognized by the taxpayer. Nevertheless, it is important to note that such provisions apply only to export sales of goods, services and rights. They do not apply to taxpayers importing goods, services and rights with foreign-related parties.

In addition, the safe harbors do not apply in case of sales transactions of rights, goods or services to buyers domiciled in low-tax jurisdiction or in jurisdiction that prohibits disclosure of equity ownership.

Low-tax Jurisdictions

In addition to the rules applicable to transactions between related parties, transfer pricing regulations set forth that such rules also apply to international transactions carried out with a person or legal entity, whether related or not, located in a so-called low tax jurisdiction. For transfer pricing purposes, a low-tax jurisdiction is deemed to be the country that taxes income at a maximum rate below twenty percent (20%). The same list of countries considered to be low-tax jurisdictions for the withholding income tax purposes is valid for transfer pricing purposes (Treasure Ruling 188/02).

Jurisdictions that prohibit disclosure of equity ownership

Normative Ruling No. 243/02 regulates certain amendments established by Provisional Measure No. 2,158-35 and Law No. 10,451/02, which determine:

- (i) the applicability of the transfer pricing rules on transactions carried out by Brazilian residents with individuals or legal entities, whether related or not, resident in jurisdictions which legislation prohibits disclosure of the equity ownership; and
- (ii) that the taxation of income derived from work (*trabalho*) and capital must be separately considered for purposes of characterizing a low-tax jurisdiction.

Book Adjustments

Law No. 10,637/02 establishes proceedings for the adjustment of the acquisition cost of goods, rights and services imported from related companies in case the acquisition cost exceeds the highest deductible amount determined according to the methods provided for in Law No. 9430/96.

For purposes of adjusting the excess related to the acquisition cost, the new legislation determines that the referred-to excess shall be debited to the accumulated profits account (*conta de resultados acumulados*), and credited to the asset account where the acquisition of the goods is registered. The intention of the legislator is to determine that the taxpayer adjusts the acquisition cost of the goods, rights or services that will be subject to depreciation, amortization or deductibility, as cost of the goods sold or the services rendered, avoiding off-book adjustments for transfer pricing purposes.

The referred-to provisions also establish that in case the adjustments are registered only in the company's fiscal books, the values considered as nondeductible, according to transfer pricing rules, may be added or considered for purposes of calculating the interest on equity.

Export Transactions Carried Out in 2005

In order to reduce the potential adverse effects on the transfer pricing calculation caused by the significant appreciation of the Brazilian currency over other foreign currencies, mainly against the US dollar along 2005, taxpayers were allowed to adjust up in 35% the export revenues recorded in 2005.

The possibility of using this 35% additional factor only applies in the following cases: (i) comparison with uncontrolled local price in order to conclude whether the 90% threshold has been achieved, (ii) comparison with the parameter price, in case the taxpayer has elected to use the Production cost plus 15% Profit Margin Method, and (iii) calculation of the average profit margin for 2005 in order to apply the 5% net profit “safe harbor” described in item 15 above.

In addition, with respect to the 5% net profit “safe harbor”, the taxpayer is allowed to calculate the minimum 5% net profit with the application of the additional 35% factor, considering solely the figures in 2005. In other words, the taxpayer is not required, for 2005, to use the average net profit margin considering the years 2004 and 2003.

[Revised as of September 2006]

Immigration

Business Visa

Under current legislation, foreign businesspersons may apply for a business visa valid for a term of up to five years. Their length of stay in Brazil is, however, still limited to an initial period of up to ninety days for every period lasting 12 months, considering the number of times they enter the country during this time. At the discretion of the federal police, this ninety-day limit may be extended to another ninety days.

Temporary Visa

If a longer stay is necessary, a temporary visa and work permit may be available for foreigners entering Brazil to work for a Brazilian company either under contract or pursuant to a technical assistance agreement. Unless otherwise noted, the temporary visa under a contract is valid for up to two years, while the temporary visa for the provision of technical assistance is valid for one year. Both of them are renewable for an equal period, unless specific stipulation is made to the contrary within the agreement or on the specific regulation concerning certain types of temporary visas.

The main characteristic of each temporary visa under a work contract and the temporary visa based on a technical assistance agreement is, respectively:

1. the expatriate is included in the Brazilian company's payroll, under a work contract. (In this case, his or her worldwide income will immediately become subject to Brazilian taxation.)
2. the Brazilian company and the foreign company sign a technical assistance agreement. (Other types of agreements, such as covenant and cooperation agreements are also accepted.) In this case, the expatriate will provide technical assistance services to the Brazilian company, and will remain on the foreign company's payroll. (In this case, his income is subject to Brazilian taxation after 183 days in Brazil.)

There are different types of temporary visas based on technical assistance that may be more appropriate in case the foreigner does not need to stay in Brazil for a long period.

In either case, the foreigner must secure a work permit in order to receive a temporary visa. Each of these visas involves a different relationship between the employer/Brazilian company and the executive/employee, and should be discussed.

In case the foreigner who will provide the technical assistance does not need to stay in Brazil for more than 90 (ninety) days, a short-term, technical assistance temporary visa may be granted without having to comply with all requirements in order to obtain the ordinary Technical Assistance Temporary Visa. Resolution n° 61 establishes that a technical assistance visa may be granted for a period of 90 (ninety days). No renewals are allowed for foreigners who need to enter Brazil to render technical assistance to Brazilian companies.

Another type of technical assistance temporary visa can be granted in case a foreigner needs to enter Brazil on an urgent basis (which must have proof) to render any kind of technical assistance service. An alternative visa does not require a work permit. Normative Resolution No. 61/04 allows for the issuance of a temporary visa in case of emergency for those petitioning under the temporary visa category to provide technical assistance. The visa may be issued by the Brazilian Consulate having jurisdiction over the applicant, and is valid for 30 days with no renewals allowed. In addition, the emergency temporary visa may be granted only once within ninety days to each foreigner.

Permanent Visa

Permanent visas related to work permits are available only to foreigners who are appointed to management positions in Brazil, as evidenced by the articles of organization of the Brazilian company sponsoring the visa. With a permanent visa and work permit, as well as in the case of the temporary one (in case the foreigner is included on the Brazilian company's payroll), the expatriates' worldwide income will immediately become subject to Brazilian taxation.

The rules that govern applications for permanent working visas also refers to permanent visas to members of the Board of Directors of a Brazilian company.

Under such rule, they are advised to obtain a permanent working visa (valid for the duration of the mandate). Different from other types of working visas, this permanent visa for members of the Board of Directors does not impose on the foreigner the obligation of transferring his/her residency for tax purposes to Brazil. Therefore, in case the foreigner does not want to pay income tax on his/her worldwide income in Brazil, he/she just needs to declare such intention in the visa application.

Restrictions on Brazilian Companies

Brazilian companies are not allowed to hire expatriates who do not hold the proper visas and work permits. Violation of this rule may subject the Brazilian company to fines and the company's officers to criminal sanctions.

Brazilian companies may obtain a temporary visa under a work contract and a work permit for expatriates only if at least two-thirds of their employees are Brazilians and at least two-thirds of their total payroll goes to Brazilians. (This requirement applies only as regards the first type of temporary visa mentioned above. With regard to a permanent visa, there is a required minimum investment in Brazil equivalent to US\$200,000 (which in some cases can be reduced to US\$ 50,000), corresponding to each work permit to be granted.

Application Process

An application for a work permit is filed with the Immigration Coordination of the Labor Ministry. When the work permit is approved, the Immigration authorities will instruct the Brazilian Consulate with jurisdiction over the applicant's domicile to issue the visa to the applicant and his or her dependents, if there are any.

The next step in the process is for the applicant and family to appear at the Brazilian Consulate with passports, a certificate indicating that the applicant has had no criminal record, marriage and birth certificates along with a detailed list of personal assets and household goods to be shipped to Brazil. If the applicant already happens to be in Brazil, a trip back to the appropriate Brazilian Consulate in the home country is required.

The Consulate will stamp the visa in the passports and approve the list of items to be shipped. Expatriates may bring personal assets, not including cars, into Brazil without tax.

Upon arrival in Brazil, the applicant has 30 days within which to file an application for a Brazilian identity card, taxpayer registration number and labor card (when applicable).

Applicants may enter Brazil during the application process on a business visa either to render services on behalf of the foreign company or to make arrangements for the transfer (e.g., to secure housing and look for schools for their children), but they may not work for the Brazilian company or be included in the payroll until their work permit is issued.

Brazilian Citizenship

A foreigner may qualify for Brazilian citizenship after four continuous years of residence in Brazil (or less, in special circumstances). Reasonable stays abroad not to exceed an aggregate of 18 months do not jeopardize this right.

The foreigner must:

1. have reached the age of majority;
2. be able to read and write Portuguese;
3. practice a profession or own capital sufficient to support himself or herself and family;
4. have had no criminal record; and
5. be in good health (a condition which shall be waived if the foreigner has lived in the country for more than two years).

[Revised as of September 2006]

Competition/Antitrust Laws

Legislation and Scope. Law No. 8.884 of 1994, as modified, forbids “violation of the economic order.” In general terms, this includes any act that limits competition, increases profits on a discretionary basis, controls twenty percent (20%) of the market share by means other than competitive efficiency, or abuses of market control. Liability for violation extends not only to the company itself, but also to managers and officers and to entities within the same group of companies.

Violations of Antitrust Laws. The law lists the conducts that are prohibited, including but not limited to the following:

- limiting or hindering access of new companies to the market;
- fixing prices in collusion with a competitor;
- regulating markets by agreement, aimed at controlling technological research and development of the production of goods and services;
- unjustifiably refusing to sell goods or render services within normal payment terms;
- obstructing the exploration of industrial, intellectual or technological property rights;
- abandoning or destroying crops or harvests for the purpose of causing difficulties, hindering competition or obtaining arbitrary profits;
- selling goods below cost aimed at market domination;
- imposing exclusivity requirements upon broadcast companies in connection with mass media advertisements;
- imposing resale prices, discounts, sales conditions, minimum and maximum quantities and profitability upon distributors and retailers; and
- severing business relations where the other party refuses to comply with terms or business conditions that are unreasonable or anticompetitive.

Registration. Any transaction that may limit competition or result in the control of more than twenty percent (20%) of a relevant market, or in which the prior fiscal year’s revenues of any of the participants exceeds R\$400 million, must be approved by the antitrust authorities (“CADE”). “Relevant market” has been

interpreted to mean not just the national market, but also regional and sector markets, effectively rendering any transaction between competitors subject to government review. The R\$400 million threshold is now interpreted by the antitrust agency as encompassing the whole economic group in Brazil⁵.

Notification to the Authority. The notification procedures are set forth in CADE Resolution n°15/1998 (“Resolution 15”). According to the Antitrust Act, the merger notice must be filed in advance or within 15 business days after the “realisation of the agreement” (which is interpreted by Resolution 15 as being the “first binding document” between the parties). The current case law is still not clear as to what constitutes a “first binding document”. Because of this, it is advisable to avoid any kind of language in preliminary documents that can be interpreted as being binding to the parties. Alternatively, the parties may take a conservative approach and elect to file the application after signing even a letter of intent, in case there is a risk that such document will be considered as a binding document by the antitrust authorities.

The Secretariat of Economic Surveillance (SEAE), an agency of the Ministry of Finance, the Secretariat of Economic Law (SDE), an agency of the Ministry of Justice, and the Administrative Council for Economic Defense (CADE), an independent federal agency, linked to the Ministry of Justice, are the agencies empowered to analyze merger control filings. The Public Prosecution Office also issues opinions on merger control filings, although usually only on complex cases.

SEAE and SDE will each have 30 days to issue their opinions, and CADE will have 60 days to decide, after it has received the dockets with the opinions issued by the two other agencies (SEAE and SDE). Requests for additional information suspend these deadlines. Once the case is at CADE, it still receives opinions from CADE’s Attorney General and from the Public Prosecution Office (if it is the case). However, the time they spend reviewing the case and issuing their opinions does not suspend CADE’s 60-day period to decide the case.

⁵ Traditionally, CADE interpreted (albeit with minority dissenting opinions) that the R\$400 million revenue threshold set forth by the competition law related to worldwide revenues of at least one of the groups of companies involved in a transaction. After a January 2005 decision, CADE changed its longstanding position and now states that the revenues to be counted are only those related to Brazil.

Currently, the Brazilian Antitrust Authorities take four to ten months in average to decide on an Act. On the other hand, the previous notice (notice prior to the execution of the document or closing of the transaction) does not accelerate the antitrust approval, since the authorities take as much time to approve the transaction as in the case of notification after signing or closing.

A “fast-track” procedure exists for the analysis of transactions which clearly do not affect competition. Under said procedure, SDE and SEAE usually do not request additional information, which reduces costs for the applicants and the time of analysis. If “fast-track” analysis is adopted in a given case, the final decision can be issued in three to four months.

Enforcement. Fines against companies range from one to thirty percent (1-30%) of gross pre-tax revenues for the preceding fiscal year (or double if there has been a recurring violation). Fines against individual managers range from ten to fifty percent (10-50%) of that amount. Foreign companies may be notified through its Brazilian subsidiary, agency, representative or local office, regardless of Power of Attorney or statutory provisions.

In addition, CADE is authorized to impose certain other penalties and remedial measures. These include ineligibility to participate in public financing or bidding; blacklisting on the Brazilian consumer protection list; withholding of patent rights; and mandatory company spin-off, transfer of corporate control or sale of certain assets or other measures to avoid harming the economy.

Law No. 10.149 of 2000 created the Leniency Program which provides that immunity be granted to companies (and its executives) or individuals which denounce antitrust violations in which such persons are participants, before such violation is known or investigated by authorities. If the violation is already under investigation, the investigated party may still obtain a reduction of between one to two thirds of the amount of the fine, provided that such party cooperates with the investigation.

Competition. Noncompetition provisions ancillary to an act of concentration are, subject to certain conditions, permitted under Brazilian law. Generally they must be limited in terms of territory, specific business and period (normally not to exceed five years). In specific cases, however, CADE may order the parties to cancel or modify the noncompetition clause, as to ensure the maintenance of competition in the affected market.

Reform. The government sent to Congress in September 2005 a bill to change the current competition statute. The bill contains substantial changes to the structure of the relevant agencies and to the rules for merger control notification and antitrust infractions. However, it is uncertain if such bill will be approved by Congress, and what changes may be introduced during the approval process.

[Revised as of September 2006]

Sales Representatives and Distributors

Sales Representatives or Agents

The Brazilian legal concept of a sales agent is rather broad, including practically any independent agent who works as an intermediary in the sale of products or services. Given the size of the country, many companies employ sales representatives so that they may best take advantage of Brazil's vast potential market. As a result, a number of rules have been established, creating an extremely protective environment for sales representatives in Brazil.

Legislation: General Requirements

Law No. 4886 of December 9, 1965, as amended by Law No. 8420 of May 8, 1992, and articles 710 to 721 of the Brazilian Civil Code regulate the activities of independent commercial representatives ("sales agents") in Brazil. The law provides that sales agents are individuals or legal entities that, without the existence of an employment relationship, are responsible for negotiating commercial transactions and soliciting purchase proposals or orders on behalf of one or more persons (the "principals").

Certain minimum protection is provided to these non-employee sales agents, along with the same general principles of labor laws for employees. The law requires that sales representative agreements in Brazil include general terms and conditions of the representation, general or specific identification of the products or articles on which representation is based, the term (definite or indefinite) of the representation, the territory, the nature (exclusive or non-exclusive) of the representation and the duties and responsibilities of the sales agent and principal.

Brazilian law does not prohibit an agency contract for a fixed term. However, a contract in force for a fixed term may be renewed for an indefinite term only. Likewise, an agency contract executed by the same parties within six (6) months after termination or expiration of another agent contract shall be mandatory for an indefinite term.

On the other hand, the major difference between an agent and an employee is that the latter is defined as the individual that renders services to a company, entity or another individual on a continuous basis, under the direction of such

company, entity or other individual, for a compensation. The giving of orders by principal to agent, as well as the payment of benefits typically due to employees such as Christmas bonus and vacation, could characterize an employment relationship between principal and the agent.

Indemnification

The law also provides for the indemnification afforded to sales agents upon termination of a contract whenever the same is requested by the principal without grounds on what the sales representative law defines as termination for “cause”. The conditions calling for indemnification are clearly favorable to and protective of sales agents, setting the minimum amount at one-twelfth ($1/12$) of the agent’s total compensation during the term of representation (duly adjusted for inflation), in case of indefinite term representation contracts. In case of termination of a fixed-term contract, the indemnification shall be equal to the monthly average of the commissions paid until the date of termination, multiplied by one half ($1/2$) of the number of contractual months, as set forth in Law No. 8420/92. Apparently there is a typographical error in Law 8420/92 as the indemnification should be the average commission calculated as above, multiplied by one half of the number of the remaining months of the contract. However, the typographical error has not yet been corrected.

Furthermore, in the case of indefinite term contracts, if the contract is terminated without cause, the terminating party is required to give a 90-day advance notice of termination or to pay a compensation equal to one-third ($1/3$) of the commissions earned by the agent in the past three (3) months.

Exclusivity of Representation

The agent is also guaranteed exclusive right to the zone of activity specified in the contract, unless otherwise stated. This exclusivity means that the agent is guaranteed the whole commission for that region, even if the company itself carries out the sales. The agent is not prohibited from representing other companies with the same or similar products in that zone unless otherwise agreed upon with the company.

Distributors

Law No. 4886 of 1965 as amended by Law No. 8420 of May 8, 1992, and articles 710 to 721 of the Brazilian Civil Code apply only to sales agents. Distributors who purchase products and resell them in their own name and for their own account are not afforded with the specific protection above.

There being no specific legislation protecting distributors, distribution agreements are governed by the Brazilian Civil Code. In the event of breach of a definite term contract before the end of the contractual term, the breaching party may be liable for damages. These damages include direct and (sometimes) indirect losses, but not punitive damages.

Due care should be exercised whenever terminating a distribution agreement with a Brazilian party contracted for an indefinite term, provided that the termination general rule set forth under the Brazilian Civil Code governs cases when the law expressly or tacitly allows, the parties may terminate the contract in case of breach of any contract provision, upon a prior notice. However, cases when due to the contract's nature certain investments were required to be made by the parties, the termination shall be valid only after a reasonable term, compatible to the nature and amount of investment, has elapsed. Therefore, it is recommended that the terminating party give prior notice as soon as possible (e.g., three to six months), so as to allow the other party sufficient time to reorganize its business, eliminate any basis for damages for unreasonable termination, and to recoup possible investments.

One exception to the absence of specific legislation covering distribution agreements is Law No. 6729 of 1979 (as amended by Law No. 8132 of 1990) which regulates the distribution of automotive vehicles in Brazil and, among other matters, provides for specific indemnification to distributor. This statute is very specific and is enforceable only with respect to Brazilian automotive industry distribution agreements. Nevertheless, there have been cases in which Brazilian courts have applied Law No. 6729/79 to ordinary distribution agreements (as a matter of analogy).

[Revised as of September 2006]

Banking and Finance

Regulatory Framework

The Brazilian Financial System is generally governed by:

- (a) the Federal Constitution;
- (b) Federal Law No. 4,595, of 1964;
- (c) Federal Law No. 6.385, of 1976;
- (d) the National Monetary Council (“CMN”) resolutions (*Resoluções*),
- (e) the Central Bank (*Banco Central do Brasil* or “Central Bank”) rulings and administrative acts (*Circulares* and *Carta-Circulares*) and
- (f) the Brazilian Securities and Exchange Commission (*Comissão de Valores Imobiliários* or “CVM”)

Federal Law No. 4,595 provides that a legal entity is considered a financial institution when its principal or ancillary activity is the collection, intermediation or investment of financial resources for its own account or for third parties, in domestic or foreign currency, as well as the custody of assets belonging to third parties. In light of this broad definition, certain activities that are somehow related to, but do not actually constitute strict banking activities (e.g., capital markets transactions) have been deemed activities carried out by financial institutions in Brazil. The Brazilian Financial System, thus, includes banking and non-banking entities under this definition.

Regulatory Bodies

The main banking regulatory agencies in Brazil are the CMN and the CVM. The Central Bank of Brazil enforces CMN’s monetary policy and is in charge of supervising all financial institutions.

CMN, a policy-making and regulatory body, is the highest entity in the Brazilian Financial System and is responsible for establishing the currency and credit policy of the country through its resolutions. CMN is comprised of the Minister of Finance as president, the Minister of State Planning, Budget and Management, and the President of the Central Bank.

The Central Bank is responsible in the implementation of currency and credit policy established by CMN and, within such policy powers:

1. supervision of the activities of all public and private financial institutions;
2. granting of their respective licenses; and
3. approval of any merger, acquisition or change in the corporate control of financial institutions.

Through DECIC (Departamento de Combate à Ilícitos Financeiros e Supervisão de Câmbio e Capitais Internacionais), the Central Bank also controls and supervises foreign capital investments in Brazil and Brazilian investments abroad.

CVM was created by Federal Law No. 6.385 of 1976 and amendments, as an independent agency with powers to regulate and supervise activities related to listed companies, as well as in connection with the issue of trade-in securities at the Brazilian stock exchange and over-the-counter markets, including investment funds.

Financial Institutions and related entities

The entities described below play a key political and financial role in the Brazilian Financial System, and are considered financial institutions.

1) Commercial Banks (*Bancos Comerciais*)

Typical commercial banking transactions include the following:

- a. granting of loans;
- b. holding of checking and investment accounts;
- c. receipt of cash deposits;
- d. receiving and processing of payments of public utility and private entities bills; and
- e. collection of drafts and other credit instruments.

Commercial banks may also obtain authorization in dealing with foreign exchange.

2) Investment Banks (*Bancos de Investimento*)

The main activities carried out by investment banks are management of investment funds and the provision of medium- to long-term debt or equity financing. Investment banks may also obtain authorization in dealing with foreign exchange transactions if they comply with the legal requirements.

3) Savings Banks (*Sociedades de Poupança e Empréstimos*)

These banks, which are mostly state-owned institutions, have a similar role to play as commercial banks as they receive savings deposits from the public.

Caixa Econômica Federal (CEF) is currently the major savings bank and one of the largest financial institutions in Brazil. Most of the loans under the Federal Housing Credit Program are granted by the CEF. It also manages the funds of the National Unemployment Compensation Fund (FGTS), the Social Integration Program (PIS/PASEP), as well as domestic lotteries.

4) Credit, Financing and Investment Companies (*Financeiras*)

Their main business consists of:

- a. financing consumer purchases of goods and services; and
- b. trading credit instruments, such as promissory notes, bills of exchange, etc.

5) Brokerage firms (*Corretoras* or “CCVM”)

They have the exclusive right to deal at the Brazilian Stock Exchange with listed securities and other negotiable instruments, under Laws No. 4.728/65 and No. 6.385/76. These companies may be established corporations or limited liability companies, and operate as intermediary parties in the said transactions. As such, they can:

- a. organize, manage and participate in consortia for underwriting and managing securities offerings;
- b. purchase and resell securities; and
- c. distribute and place securities in the capital market.

CMN Resolution No. 1.655/89, as amended by Resolution No. 2.099/94, regulates CVM's organization and operation and specifies all activities that such companies may perform.

6) Dealers (*Distribuidoras de Títulos de Valores Mobiliários* or "DTVM")

These companies are also subject to Laws No. 4.728/65 and 6.385/76. Their main business is subscribing to securities issuance for resale or distribution, thus acting as intermediaries in the placement of public offerings. Their business is similar to that of brokerage firms, although they may not directly deal at the stock exchange. The organization and operation of such firms are set forth in CMN Resolutions No. 1.120/86 and No. 1.653/89, and may be organized as corporations or limited liability companies.

7) Currency Exchange Brokerage Companies (*Corretoras de Câmbio*)

These institutions, regulated by CMN Resolution No. 1.770/90, perform foreign currency exchange transactions, and may be organized as corporations or limited liability companies. Other financial institutions may be permitted by the Central Bank to deal with currency exchange.

8) National Economic Development Bank (*Banco Nacional de Desenvolvimento Econômico e Social* or "BNDES")

BNDES is a state-owned financial institution which acts as an auxiliary agency in the implementation of the federal government's credit policy. Its principal activities include financing industrial, agricultural, and commercial projects.

9) Banks with multiple portfolios (*Bancos Múltiplos*)

Bancos Múltiplos were created under the umbrella of the 1988 financial system reforms and are now regulated by CMN Resolution No. 2.099/94. The main purpose of multiple banks is to enable a single financial institution to maintain different types of portfolios (that is, allowing the performance of all activities pertaining to financial institutions described in items 1 to 4 above), which, in turn, significantly increases the administrative efficiency among banking

conglomerates. As a matter of fact, almost all banks in Brazil are authorized to act as Bancos Múltiplos (in the past, banks were required to have one license for each type of activity).

The state-owned Banco do Brasil S.A. is the largest multiple bank, despite the fact that most banking activities are carried out through private Bancos Múltiplos.

10) Leasing Companies (*Sociedades de Arrendamento Mercantil*)

The main role of leasing companies is to enter into leasing transactions.

Incorporation of Financial Institutions

The operation of Brazilian financial institutions is subject to the authorization of the Central Bank. To obtain such authorization, the financial institution must produce documents attesting:

1. its financial conditions which must be compatible with the proposed undertaking;
2. good standing of its directors and officers;
3. payment of a certain minimum capital requirement; and
4. acceptance of certain protection mechanisms of creditors.

The total assets of the controlling shareholders or partners, whether direct or indirect, must be equal to or greater than 220% of the investment in the new institution. The Central Bank grants authorizations for an indefinite, non-negotiable and non-transferable term.

Corporate Structure

Depending on the type of transaction, a financial institution may be incorporated in Brazil as:

1. a representative office or branch of a foreign financial institution or
2. a subsidiary, as corporation (*Sociedade por ações*) or limited liability company (*Sociedade Empresária Limitada*).

Most financial institutions (such as banks and leasing companies) may not be organized as limited liability companies.

Pursuant to Resolution No. 2.099/94 enacted by CMN and published by the Central Bank, financial institutions must obtain authorization from the Central Bank to, among other acts:

1. modify their corporate purpose;
2. convert into a multiple bank (except for leasing companies that may not do so);
3. change their corporate nature; or
4. merge with or acquire other financial institution.

Representative Office or Branch of Foreign Entity

Establishing a branch of a foreign financial institution is a bureaucratic and cumbersome process as it requires the Brazilian President's authorization by decree, issued on a reciprocal basis. In addition, the organization of a branch is generally not recommended due to tax and immigration requirements and implications.

Meanwhile, the organization and operation of representative offices are regulated by CMN Resolution No. 2.592/99 which provides that a representative office of a financial institution whose headquarters are located in a foreign country requires the Central Bank's authorization, which is normally granted to individuals.

However, if the institution has its headquarters in Brazil, a company may also be authorized by the Central Bank to act as legal representative of a foreign bank. Representative offices can only perform marketing and promotional roles, and can not carry out any actual banking activity.

Foreign-Owned Bank Subsidiaries

All banks shall be organized as corporations and at least 50% (fifty percent) of the stated initial capital (conforming to the applicable minimum capital requirements depending on the type of bank) shall be paid at the time of incorporation. The balance must be paid within one year and before any credit or guarantee operations can commence.

Article 52 of the Transitory Constitutional Provisions Act (*Ato das Disposições Constitucionais Transitórias*) of the Brazilian Federal Constitution of 1988 prohibits foreign financial institutions from:

1. opening new branches of financial institutions domiciled abroad; and
2. increasing their equity interest in Brazilian financial institutions, except if authorized by international agreements providing for reciprocity or, in the event such transactions are in the interest of the Brazilian government.

The Federal Government tends to treat most acquisitions of Brazilian financial institutions by foreign investors as in the best interest of the country. As a result, such institutions interested in receiving foreign equity interest may present a proposal to the Central Bank, which shall review and submit it for CMN's approval, the latter forwarding the request to the President of Brazil for final authorization by decree. The formalities and timing of approval depend on the structure of the transaction. For instance, if foreign interest is obtained through the issuance of new shares rather than the purchase of existing ones, the new subscription amount must be deposited at the Central Bank prior to obtaining final approval for the change in control. In addition, the Central Bank may require that the foreign [investor] purchase certain assets (i.e., loans receivable) of banks under intervention or liquidation.

Operational Requirements

The Central Bank imposes certain operational rules on financial institutions, including:

1. the period during which bank agencies may remain open to the public;
2. operational limits for certain financial transactions;
3. formalities in the recording financial transactions; and
4. requirements for opening new branches.

Moreover, Brazilian financial institutions are subject to the Basel Convention rules, incorporated into the Brazilian law under CMN Resolution No. 2.099/94, as amended. This regulation sets forth the minimum capital flow and net worth for a financial institution to be organized in Brazil, as well as the formula for the

calculation of the Demanded Net Worth (“*Patrimônio Líquido Exigido*” or “PLE”), which a Brazilian financial institution must maintain as to any risks that may be incurred in the transactions frequently entered into.

Bank Secrecy

Financial institutions shall maintain the confidentiality of all information regarding their clients and respective transactions. Client information may be disclosed only upon judicial order or as required by law. Various measures have been adopted to lift such secrecy rules for criminal investigations and law enforcement.

Money Laundering Rules

Federal Law No. 9.613 of 1998 lists transactions that are considered money laundering and defined as crimes. The same law creates the Council for the Control of Financial Activities – COAF (*Conselho de Controle Atividades Financeiras*), an agency subordinated to the Ministry of Finance responsible for the regulation and investigation of transactions suspected as money laundering. The COAF has the power to impose administrative penalties. Some entities, such as stock exchanges, commodities exchanges, derivative exchanges, banks, securities brokers and dealers, insurance companies, and factoring companies, shall inform the COAF of transactions which violate money laundering laws. Moreover, any transaction conducted with those entities involving assets that can be converted into currency exceeding R\$10,000 (ten thousand Brazilian Reais) shall be reported to the COAF. The Central Bank has published certain rules regarding money laundering.

Domestic Branches

The establishment of branches by Brazilian financial institutions shall follow the requirements of Circular No. 2.501. Moreover, Exhibit III of Resolution No. 2.099/94 provides that *Bancos Múltiplos*, commercial banks, investment banks, savings banks, securities brokerage firms, dealing firms and currency exchange brokerage firms may establish up to ten (10) branches in Brazil. The establishment of additional branches is contingent upon the stated capital and net worth of the financial institution, and subject to the Central Bank’s approval.

Bankruptcy and Reorganization

Financial institutions are subject to a special insolvency system in Brazil and the regular insolvency system under Law No. 11,101 enacted on February 9, 2005 is not directly applicable. Rather, financial institutions are primarily subject to Law No. 6,024 enacted on March 13, 1974, which provides for a specific insolvency system encompassing two different administrative measures by the Central Bank: the extra-judicial intervention (*intervenção extra-judicial*) and the extra-judicial liquidation (*liquidação extra-judicial*). The intervention may occur in case of:

- (i) losses arising out of mismanagement;
- (ii) violation of rules resulting in significant losses; or
- (iii) occurrence of facts constituting bankruptcy, as provided under Articles 94 of Law No. 11,101/05 (corresponding to Articles 1 and 2 of the revoked Decree-Law 7661/1945).

During the intervention, a trustee appointed by the Central Bank will carry out an investigation which will interrupt the institutions' operations for up to six (6) months. The extra-judicial liquidation represents an extreme measure, at Central Bank's discretion, and it is taken to prevent the insolvency of financial institutions. It may occur even without the submission of a prior request for intervention. The interruption of activities may be avoided under the RAET (*Regime de Administração Especial Temporária*), created by Decree-law 2,321 enacted on February, 25, 1987. In addition, the Central Bank is authorized as a consequence of the intervention, RAET or liquidation or as a preventive measure, among other things,

- (i) to reorganize the financial institution or
- (ii) request the expropriation (eminent domain) of the shareholding ownership of the financial institution in favor of the Federal Government.

Law No. 6,024/1974 also provides for the possibility of a subsidiary application of Law No. 11,101/2005 to the intervention and liquidation proceedings. In addition, as provided under Article 21, item "b" of Law No. 6,024/1974, it would be possible to lift the bankruptcy of a financial institution, provided that the following conditions are complied with:

- a) the liquidation survey concludes that the assets are not sufficient to cover at least 50% (fifty per cent) of the liabilities;
- b) the complexity of the business or the seriousness of the financial condition requires that a more severe measure be taken;
- c) the extra-judicial liquidation requested to the Central Bank is deemed inappropriate.

Proposed Legislation

The 1988 Federal Constitution provides that a Complementary Law shall regulate Brazilian financial institutions, Central Bank activities, and insurance companies, among other things. A bill for the Complementary Law was proposed in 1988 to a committee of the Brazilian Congress created especially for this purpose. Since then, the bill has been subject to debate among interested financial and commercial groups, and a revised text continues to be amended since 1991. At present, it is difficult to predict when the regulations will be enacted.

[Revised as of September 2006]

Consumer Protection

The Brazilian Consumer Protection Code (Federal Law No. 8078 of September 11, 1990) (“CDC”) establishes the legal principles and requirements applicable to consumer relations in Brazil. The CDC regulates, among other things, product and service liability, contractual clauses, commercial practices, advertising and relevant information on consumer products and services. The CDC also includes rules on civil procedure for individual and collective claims, including class actions, as well as administrative and criminal sanctions.

Suppliers and Consumers: Definitions

The CDC defines a supplier as any private or public individual or legal entity, Brazilian or foreign, which manufactures, assembles, creates, builds, transforms, imports, distributes or markets products or renders services to consumers. The CDC defines a consumer, as a general rule, as any end-user (whether individual or legal entity) which acquires or uses products or services.

By this definition, the CDC governs not only retail sales, but also sales of products and services to manufacturers, who will be treated as consumers when they are end-users of products and services. This is an important and controversial change in business relationships which differentiates the CDC from the consumer protection laws of other countries.

Basic Rights of Consumers

The CDC establishes, among others, the following basic rights of the consumer:

1. safeguard of life, health and safety against risks caused by practices in the supply of products and services considered hazardous or harmful;
2. education and communication on the proper use of products and services, enabling free choice and equality in contracting;
3. appropriate and clear information on the different products and services, and correct specification as to the quantity, characteristics, components, quality and price, and risks they might involve;

4. protection against misleading and abusive advertising, and coercive or dishonest business methods, as well as against practices and abusive clauses or those imposed in the supply of products and services;
5. amendment of contractual clauses which establish unreasonable obligations, or their revision in view of subsequent events that turn obligations excessively burdensome;
6. effective prevention against and redress for individual, collective or diffuse material and moral damages;
7. access to jurisdictional and administrative bodies regarding the prevention or redress for individual, collective or diffuse material or moral damages, legal, administrative and technical protection is ensured to the consumer;
8. immediate defense of the consumer's rights, including the reversal of the burden of proof in his favor in the civil proceedings when, at the judge's understanding, the allegation is probable or, he is at a disadvantage according to the ordinary rules of experience;

Information and Advertisements

Pursuant to the CDC mandate, suppliers are liable for any and all information and advertisement regarding their products or services. The CDC also contains specific provisions prohibiting misleading or abusive advertising.

Potentially hazardous or dangerous products and services are required by law to bear clearly visible and adequate information, in Portuguese, about any risks of usage.

The manufacturer, producer, builder, supplier of services or importer, regardless of nationality, is strictly and jointly liable for any damages caused by insufficient or inadequate information on the use and the risk factors associated with the product, as well as if damage is a direct result of services rendered or of the product's defective design, manufacture, construction, assembly, formula, manipulation, presentation or packaging.

Contractual Rights and Protection

Specific provisions under the CDC ensure the contractual rights and protection of consumers. The CDC provides that certain abusive clauses will automatically be deemed invalid if included in a contract, such as:

1. limitation of suppliers' liability;
2. restriction on the consumers' right to return products or services and, to reimbursement;
3. transference of suppliers' liabilities to third parties;
4. shifting the burden of proof to the consumer in the event of litigation;
5. creation of excessive disadvantages to the consumer; and
6. requiring the consumer to bear costs of collection.

Administrative Rulings issued by the Economic Law Department of the Ministry of Justice include new examples of abusive clauses which will be invalidated. They include, among others, preventing consumers from taking advantage of a more favorable event, pursuant to a contractual warranty term; imposing sanctions in case of delay in complying with an obligation or default by a consumer; electing a court to resolve disputes related to consumer relations other than courts of jurisdiction where the consumer lives; hindering, reducing or impairing the application of CDC rules to disputes arising from air transportation, agreements which impose time limits for hospitalization other than those prescribed by a physician; and restricting the consumer's right to question any possible damages arising from executed agreement within the judicial and administrative level.

Products Liability

The CDC has established two types of products liability:

1. liability resulting from damages caused by the product (Art. 12); and
2. liability resulting from qualitative or quantitative defects of the product (Art. 18).

Liabilities resulting from damages caused by the product

The CDC contains specific rules providing that the manufacturer, producer, builder, or importer, regardless of nationality, will be held strictly both jointly and severally liable if the damage incurred by the consumer is a direct result of the product's defective design, manufacture, construction, assembly, formula, manipulation, presentation, or packaging. These parties will be held liable if the damage is a direct result of the services rendered or, of insufficient or inadequate information regarding the product's use and risks.

In addition, if the damage is caused by a component or device which was incorporated to certain products or services, the manufacturer, builder or importer and the third party responsible for such incorporation will be held strictly both jointly and severally liable, unless they are able to prove that:

1. they have not distributed the products in the market; or
2. the defect deemed as cause of the damage does not exist; or
3. the damage is a result of the fault of the consumer or a third party.

Liabilities resulting from qualitative or quantitative defects of the product

According to the CDC, the suppliers (physical or legal entity, regardless of nationality, that perform activities of production, assembly, creation, construction, transformation, importation, export, distribution, or commercialization of products or services) are jointly and severally liable, regardless of fault, for qualitative or quantitative defects of products. For the purpose of this provision, a product is considered defective when it presents qualitative or quantitative changes that:

1. make the product inadequate or unfit for its ordinary purpose; or
2. diminish the product value; or
3. result from differences between the product and the related data of packages, recipients, labels or publicity messages, unless these differences are inherent to the product.

The CDC also dictates administrative and criminal penalties which may be applied against suppliers (e.g., seizure and destruction of products, fines and imprisonment).

Warranty

The CDC establishes two kinds of warranty: the legal and the contractual warranty. The legal warranty is comprised of a series of provisions of the CDC, which establishes a minimum set of consumer protection requirements, including the imposition of a strict civil liability regime for damages caused by the product or service or, for the product's imperfections which may not be disclaimed as a matter of public policy which cannot be waived.

When a product is covered by legal warranty, the consumer can demand replacement of the defective parts. If the supplier does not correct the imperfection within 30 days from the consumer claim, the consumer may demand, at his option:

1. replacement of the product by another of the same kind, in a perfect state;
2. immediate reimbursement of the amount paid, with monetary updating, notwithstanding his right to recover any losses and damages; and
3. proportionate price reduction.

On the other hand, contractual warranties are those offered by the suppliers under their own discretion. They are deemed complementary to the legal warranties and must be expressly stated in documentation written in Portuguese, accompanying the products.

The warranty certificate must follow a standard and appropriate explanation of what such warranty consists of, as well as the manner, period of time and place where it can be exercised. Any charge at the consumer's expense must be handed to the consumer duly filled out by the supplier upon delivery of the good or service, accompanied by an illustrated operations handbook.

Statute of Limitations

The CDC also sets time limits and prescriptive periods during which consumers may exercise their legal warranty rights to raise product liability claims against suppliers:

1. 30 days for nondurable and 90 days for durable products and services from the date of delivery of the product or termination of the rendering of service for immediate and easily verifiable defects;
2. The same periods mentioned above from the date that concealed defects are discovered; and
3. Five years for claiming damages caused by a defective product or service to third parties.

Limitation of liability

The CDC expressly prohibits contractual provisions that limit or exonerate a supplier's responsibility for inadequacy of products and/or services or, for damages caused by products or services. The only exception is that, in consumer agreements between two legal entities, parties may limit the value of the supplier's indemnification in justifiable situations.

Disregard of corporate entity (or piercing of the corporate veil)

The court may disregard the corporate entity when, to the consumer's detriment, abuse of rights, excessive power, breach of law, illicit act or fact, or violation of the bylaws or articles of the organization. It shall be also exercised in the event of bankruptcy, insolvency, closure, or inactivity of the legal entity resulting from mismanagement.

Legal entities may also be disregarded when their identity hinders indemnification of damages caused to consumers.

Recall

The CDC provides that suppliers are not allowed to introduce into the market products or services that are highly harmful or hazardous to consumers' health or safety. If the supplier, subsequent to the introduction of his products or services, realizes the existence of unforeseen risks involved, he/she must recall such products and immediately communicate the fact to competent authorities and warn consumers through advertising notices in the print media, radio and television at his/her own expense. The recall is also ruled by an administrative ruling issued by the Ministry of Justice.

[Revised as of September 2006]

The Power Industry

Unlike other infrastructure industries in Brazil, the power industry began in the late 1800s as a private investment. It was not until the early 1950s, due to a postwar nationalization wave, that the sector became predominantly state-owned. In the mid-1990s, the Brazilian federal and state governments carried out one of the world's largest privatization programs in the power sector, and all restrictions to foreign investment have been lifted. However, the private model has never been fully implemented, and as a result Brazil faced a severe energy crisis in 2001 which led to rationing and price hikes, followed by a sharp reduction in demand causing financial distress to the industry. Since 2003, the new federal administration has been taking a series of actions to bail out the indebted companies and remodel the industry's legal framework. In March 2004, Law No. 10,848 introduced a new regulatory model deeply changing the rules on the trade of electric energy.

Industry Overview

Historically, the power industry has been enjoying outstanding growth. According to Eletrobrás, Brazil's installed capacity increased from 8.7 GW in 1970 to 63.2 GW in 2000. In 2006, the installed capacity was at 96 GW (of which 71.7 GW and 22.6 GW correspond to hydroelectric and thermoelectric power, respectively). Unlike in most countries, Brazil's power industry is primarily based on hydropower generation, which in 2006 accounted for 74.68% of its installed capacity.

Thermoelectric generation is generally regarded as an important supplementary source for use in the isolated systems and/or in periods when hydroelectric power is scarce/expensive. New sources of gas supply (mostly from Argentina and Bolivia and the recent discovery in the Santos basin), as well the abolition of the state monopoly on upstream prospecting, will boost thermal expansion. More recently, the government unleashed a program to foster "alternative energy sources" in the form of biomass, wind, and small power plants.

The first large power generating company was privatized in 1998, while the important generating companies were privatized in 1998 and 1999. However, the privatization of energy firms controlled by the federal government was suspended in 2004. Currently, only 20% of the generation is controlled by the private sector

Of Brazil's 250,268 kms of transmission lines, 174,806 kms (69.85%) are high-voltage (230 kV or more). Federal-owned Eletrobrás controls more than 51% of such high-voltage lines, the remainder of which is owned by public utilities, state and municipal governments. Given the unique features of hydropower, most plants in Brazil are interconnected to regional systems and are subject to control of their respective dispatch by the National System Operator (ONS), which is responsible for the dispatch, scheduling and planning of generation, as well as coordination and management of the transmission grid. Such interconnection/coordination allows power plants be part of energy pools through which they can trade excess capacity, thus reducing waste.

The country is divided into two interconnected systems: the South/Southeast/Center/West and the North/Northeast systems. In addition, several isolated, non-interconnected systems exist, mostly in the far north. In 1999, with the implementation of the North/South Transmission Lines, these two systems were connected, creating a National Interconnected System which carries approximately 98% of Brazil's electricity.

For the use and interconnection to the Brazilian Interconnected Basic Grid, agents must execute two agreements:

- (i) one for interconnection to the Grid (*Contrato de Conexão à Transmissão* or CCT) by paying the correspondent fees, and
- (ii) another for the use of the transmission lines of the Grid (*Contrato de Uso do Sistema de Transmissão* or CUST) also by paying the use fees established by ANEEL. Other connection contracts may also be needed depending on the ownership of the transmission facilities.

The exploration of the transmission line system was also opened to the private sector through the grant of authorization for operation and maintenance. The purpose of the authorization is two-fold: to expand the national market's supply capacity and to allow industry agents free access to the Brazilian Interconnected Basic Grid. From 2001 to 2004, the federal government successfully granted 22 concessions representing 5,935 kms of transmission lines.

Utilities supplied more than 241,909 GW/hr to 47 million customers in 1999 and 253,487 GW/hr to 49 million customers in 2000. On the average, the demand increases at a rate of 5% per annum. Approximately, 50% of the utilities have been privatized.

Regulatory Overview

The Brazilian Constitution grants the federal government power to legislate over energy matters, as well as ownership rights over hydropower resources. Conversely, the Constitution requires that the federal, state and municipal governments render to the public certain services, including the supply of electricity. The power to explore energy resources and the responsibility of supplying electricity may be delegated by the government to private entities. Such delegation is generally granted and regulated by concession/permission contracts and authorization deeds (see chapter on Concessions).

Brazil has been undergoing a comprehensive regulatory reform since it started the privatization program in 1995. To date, the major legal bases are:

1. the Federal Constitution of 1988 as amended by the Sixth Amendment of 1995, which eliminated certain restrictions to foreign investment in the industry;
2. the Water Code (Decree 24,643 of 1934),
3. the Antitrust Statute (Law 8884 of 1994);
4. Law 8631 of 1993 which altered the rate-making rules;
5. the Statute of Concessions (Law 8,987 of 1995);
6. Law 9074 of 1995 which allowed the formation of independent power producers;
7. Law 9427 of 1996, which created ANEEL (see below),
8. Law 9648 of 1998 which created the Wholesale Energy Market - "MAE" (see below),
9. Laws 10438 and 10433 of 2002, and

10. Law 10,848 of 2004 which restructured the institutional framework and changed the rules on the trade of electric energy (see paragraphs below). Some of the above statutes are still regulated at the time of this writing.

In 1996, Law 9427 created the independent agency “ANEEL” to regulate and monitor the electric industry. Along with other objectives, ANEEL shall implement the federal government’s electric energy policies and directives, and provide and enforce industry regulations in connection with antitrust restrictions, tariffs, quality standards, and transmission fees. By means of cooperation agreements, it may delegate inspection and enforcement powers to local agencies.

The new institutional framework introduced by Law 10,848 centralizes in the Brazilian Government the power to set policies, plan and monitor the industry. ANEEL implements government policies and inspecting industry players. The players continue to participate in the entities responsible for energy trading and system operation, however not keeping the same controlling power as before.

The major entities are the National Energy Council (*Conselho Nacional de Política Energética*), the Ministry of Mines and Energy, the Energy Research Company (*Empresa de Pesquisa Energética*), ANEEL, the Chamber for Trading of Energy (*Câmara de Comercialização de Energia Elétrica* or “CCEE”) which shall replace MAE and manage both the regulated and unregulated markets, the National System Operator or “ONS” (now tightly controlled by the government) and the Energy Industry Monitoring Committee (*Comitê de Monitoramento do Setor Elétrico*).

Moreover, the new regulations delegated broad discretionary powers to the Executive Branch to regulate the new model. In several cases, the statute sets forth only certain guidelines or “factors” to instruct the regulatory decrees.

Trading Energy in the New Model

Law 10,848 significantly changed the rules on the trade of electric energy in Brazil. The energy can only be contracted under the rules of either the so-called “Regulated Contracts Framework” (ACR in the Portuguese acronym) or the “Unregulated Contracts Framework” (ACL in Portuguese).

Under the ACR, one sells electric energy that public utility distribution companies used to supply their end users. Except for specific cases as mentioned below, the distribution companies cannot acquire electric energy out of the ACR. The sale of electric energy under the ACR shall be made through bidding conducted by ANEEL or by CCEE, if so delegated by the former. The winning bidder shall execute a power purchase agreement with all the distribution companies connected to the Brazilian grid. ACR contracts shall be fully-regulated.

Under the ACL, one sells electric energy to the so-called “free” customers through bilateral contracts freely negotiated. ACL’s contracting rules should be very close to the existing rules applicable to the free market. Because the distribution companies will not be allowed to purchase from the ACL (except as provided below), the volume of energy to be freely traded is limited.

Environmental Controls

Any business activity, which may cause harm to life and the environment, is subject to environmental controls (please refer to chapter on Environmental laws). Under existing regulations, the construction of power plants with a capacity greater than 10 MW requires the submission and approval of an environmental impact report (“RIMA”). RIMAs must discuss alternative technologies and locations, identify and evaluate the environmental impact during construction and operation, define the affected areas, and evaluate whether governmental plans within the construction area are compatible with the project.

Forms of Doing Business

The industry businesses are generally done in two main forms: public utilities and independent power producers/self-generators. Each form is subject to distinct guidelines which are briefly described below. In either case, a concession or an authorization is required.

Public Utilities

Public utilities (concessionárias de serviço público) are entities with a concession or permit to provide electricity to the public. The rights and obligations arising from the concession/permit are set forth in a concession/permission contract (see chapter on Concessions).

Generally, concession contracts last for a term of up to 35 years for generation or for a term of up to 30 years for transmission and distribution. Extensions are permitted for an additional term. The rationale for the length of the terms and extensions is that the investor must be allowed sufficient time to amortize its investment.

Several utilities have already been privatized and are currently run by private foreign and domestic investors. Privatized utilities usually have their prior concession contracts replaced by new ones that already incorporate current legal requirements. The concession terms are renewed accordingly.

The major advantage of a public utility is the right of exclusivity over a service area (such right does not apply to large customers), areas supplied by cooperatives, or other exceptional cases provided by law. In consideration for such monopoly, the utilities must observe certain obligations, mostly focused on public interest, such as rendering services on a regular, efficient and safe basis, expand the company's business, and to observe quality standards.

Public utilities are also subject to price controls enforced by the concession authority. The law requires that tariffs should be reasonably moderate and nondiscriminatory among customers. Current tariff formulas allow pass-through of costs subject to certain caps. Tariffs are adjusted annually for inflation and revised according to performance targets within periods varying from three to seven years. Public utilities may also seek alternative revenue sources, complementary or accessory to the public service being rendered to the extent permitted by law. The additional revenue resulting therefrom shall be subject to the tariff revisions mentioned above.

In accordance with the new energy model, energy distribution companies must acquire the totality of their energy requirements through:

1. ACR-regulated contracts, and

2. contracts derived from distributed energy, alternative sources (acquired in the first phase of the PROINFA program only) and *Itaipu Binacional*.

The distribution companies shall inform the Government of their energy requirement as necessary to supply their forecast demand, and will be subject to penalty in case of deviation.

The new statute also determines the unbundling of the distribution public utility companies. These companies shall no longer:

1. develop generation or transmission activities,
2. sell energy to “free” customers out of their concession area,
3. hold equity interest in other companies (except for equity participation related to financing transactions for the benefit of the public utility distribution company, subject to ANEEL’s authorization), or
4. develop activities not related to the purpose of their concession.

The distribution public utility companies may exceptionally execute new contracts related to the activities set forth in items 1 to 3 above, provided that the terms of such contracts do not go beyond December 11, 2004. The generating companies cannot control or be “related to” (i.e., hold 10% or more equity) public utility distribution companies. They must unbundle their activities within 18 months (extendable for another 18 months) as of March 15, 2004.

The power purchase agreements executed by the distribution companies up to March 16, 2004, as well as those to be executed not later than the actual start-up of the bidding, shall be treated under the ACL rules until their termination. However, contracts that are already registered with or approved by ANEEL until March 16, 2004 cannot extend their term or their energy amounts or increase their prices (except for the amendments of the so-called “initial contracts” or equivalent instruments).

The distribution companies which fail to pay regulatory charges such as RGR, PROINFA, CDE, CCC, etc., or fail to pay under the regulated or the Itaipu contracts will not be entitled to the periodic tariff reset or annual tariff adjustment.

Independent Power Producers (IPPs), Self-Generators and Generating Companies

IPPs and self-generators do not receive public service concessions or permits to render public services. Rather, they are granted authorizations or specific concessions to explore water resources that merely allow them to produce, use or sell electric energy. The IPP may sell part or all of its output to customers on its own account and risk. The self-generator may sell or trade any exceeding energy it is unable to consume, upon specific authorization from ANEEL.

IPPs and self-generators are not granted monopoly rights and are not subject to price controls, with the exception of specific cases. The IPPs compete with public utilities and among themselves for large customers, pools of customers of distribution companies or any customer unattended by a public utility.

Project sponsors and lenders should pay particular attention to the intricacies of current law when negotiating or reviewing project documentation. In addition to the above-mentioned authorization deed, the rights and obligations of IPPs are stated in the power purchase agreements (PPAs) they execute with customers. Except for ACR contracts, PPAs do not follow a specific standard, and the regulatory framework is not as organized and thorough as it is in other countries with project financing history. Nevertheless, certain important terms may be secured through the proper use of our codified contract law and the construction of existing industry principles.

Generating companies may sell electric energy either in the ACR or the ACL. The ACR sales are made through biddings. One will promote distinct bidding for energy derived from:

1. existing projects (the so-called “existing energy”),
2. new projects (“new energy”), and
3. alternative sources

The new statute defines new projects as those that, up to the start of the bidding, do not hold license or are expanding of existing projects. Nevertheless, certain existing projects are allowed to compete with new ones in contests carried

forward until 2007, provided they obtained license up to March 16, 2004, and started commercial operations as of January 1, 2000 and were unable to contract their energy until March 16, 2004.

The bidding for new energy shall supply the projected additional requirements of the distribution companies. The PPAs shall have a term of 15-35 years and the delivery of energy should start within three to five years. The hydrologic risks may be assumed either by the generator, in the case of “contracts for energy quantities”, or by the distribution companies with a pass-through of costs to end customers in case of “contracts for availability of energy”. In case of rationing, the contracts for energy quantities shall have their amounts adjusted in the same proportion as the applicable rationing restrictions.

Generators awarded concessions for “new” energy derived from hydroelectric sources shall operate under the regime of “public utility” instead of IPPs or self-generators. Accordingly, these companies shall be subject to general limits, tariffs, obligations and rights provided in their concession agreement (see item above on public utilities). Those generators which want to sell part of the energy in the ACL (provided that it is so allowed under the respective bidding rules) shall “indemnify” the ACR member by paying an amount corresponding to the positive difference between the marginal cost established for that particular project and the price bid of the generator.

The bidding for the existing energy shall supply the market of the public utility distribution companies. The PPAs shall have a term of three to 15 years and the energy supply shall start in the year following the bid, except for those occurring in years 2004, 2005 and 2007, which contracts may allow the generators to start delivery of energy within a maximum of five years. These contracts shall be formatted as “contracts for energy quantities” in which the hydrologic risks are assumed by the generation company.

State-owned generators may sell energy directly to customers, but under more restrictive conditions. They may sell energy through tender offers or by RFPs conducted by the end users. In addition, these companies may:

1. extend existing contracts (which took effect on August 26, 2002 and will be valid until the end of 2010) with end users, provided that such extended contracts are amended to segregate transmission and energy price components, and

2. conduct public tender offers to supply new customers or additional requirements of existing customers, in both cases involving 50MW or more for a 10-year period (renewable for another 10 years).

Consumers

The new statute follows the historical trend of passing costs to the end user. It is true that Law 10,848 has brought certain guidelines and general references to the principle of “reasonable tariffs” (*modicidade tarifária*), as well as to the limits of cost pass-through. However, customers will clearly bear the costs of the bidding in the regulated market, including charges and taxes. Furthermore, the costs with the acquisition of back-up capacity and the contracts for “availability of energy” (through which generators will be paid regardless of the actual delivery of energy to the system) shall also be borne by the end users. They shall also bear the costs of the CDE charge, which shall be included in the distribution and transmission fees.

Article 28 of Law 10,848 contains the principle which ensures “equal treatment” between regulated and “free” (unregulated) customers as far as regulatory charges are concerned. This principle may turn out to be an important tool to protect the customers.

The new model maintains the right of key consumers to become “free” or unregulated. Free customers may acquire electric energy from energy trading companies, generators (either independent producers or public utilities), and even the local distribution company (though under regulated conditions). However, the new statute imposes severe restrictions with respect to:

1. the exercise of the option for the unregulated condition and the return to regulated status, and
2. the obligations and penalties of such customers vis-à-vis the electric system.

The free customer option must be exercised within 36 months. Return to the regulated condition must be requested at least five years in advance. The prior notice for free customer status was exceptionally reduced to only 180 days for customers who intend to develop self-generation facilities. This exception will be valid until December 31, 2009.

In addition, the free customer must inform its load requirement to the Government and shall contract the totality of such load, subject to penalties in case of forecast deviation. He/she must also join the CCEE (substitute for the wholesale energy market “MAE”).

Finally, the new statute provides that the distribution companies can interrupt supply to certain customers under specific circumstances.

Consortia

The investors may form a consortia to generate electric energy under the regime of public utilities, IPPs or self-generators, subject to applicable regulation. Under Brazilian laws, consortia are non-incorporated entities, and each consortium member shall be a party to the relevant concession contract, and shall be jointly and severally liable among each other for the concession/authorization obligations. They are strongly advised to execute detailed consortium agreements, operation agreements, and other documentation defining their rights and obligations.

[Revised as of September 2006]

Environmental Protection

Environmental protection is reflected in the Federal Constitution and federal, state and municipal legislation, international treaties and the provisions of MERCOSUR⁶. The scope of liability for polluters and the standards for environmental protection for pollution emission are, in some cases, at a level comparable to those of developed nations. Some states, including São Paulo, have established supplemental rules and standards that exceed federal minimums.

Federal and state District Attorneys, as well as Brazilian nongovernmental organizations (NGOs) registered with public record offices have standing orders to sue polluters for money-damages and specific performance (e.g., cleanup or recovery of damaged areas) in public civil actions (similar to US class actions) regulated by Federal Laws No. 7,347/85 and No. 8,078/90. Although individuals are not entitled to sue under Federal Law No. 7,347/85, they may sue to recover personal damages under Brazilian nuisance and tort laws.

Environmental protection agencies at the state and federal levels have concurrent jurisdiction to control the quality of water for public consumption and other certain uses, establish environmental standards and discharge limitations, issue construction and operating licenses for new and existing sources of pollution, monitor polluting activities, and to shut down serious violators, temporarily or permanently.

In general, administrative penalties against polluters include warnings, simple and daily fines, denial of public subsidies and financing, and partial or total suspension of plant operations. These and other administrative penalties have been established by Federal Decree No. 3,179/99 which regulates Federal Law No. 9,605/98 (the “Environmental Crimes Law”).

Federal Law No. 9,605/98 establishes criminal and administrative liability for damage to the environment. The law imposes severe criminal punishment on individuals and legal entities that contribute to environmental damage, including officers, controllers, management boards, managers and employees of legal entities.

⁶ Brazil is a member of the Southern common market established in Asuncion, Paraguay in 1991.

The law provides for crimes against fauna and flora, against urban order and historical sites, and against the environment as a whole. Pollution crimes elicit more severe penalties, such as imprisonment of up to five years, and fines whenever environmental or human health is compromised as a result of the emission of liquid, gas or solid residues outside the legal parameters.

Under this law, environmental licenses will play a very important role. Lack of environmental licenses (installation or operating) is listed as a crime and may result in the interdiction of the activities, as well as confinement. Environmental agencies have been more strict on the issuance of such licenses, since they are also subject to criminal punishment for issuance of licenses to companies that do not comply with environmental laws. The law also provides for piercing the corporate veil in any situation where the existence of a legal entity is a barrier to the recovery of damages caused to the environment.

Penalties for such crimes are severe and may include restrictions on certain freedoms (imprisonment and confinement), rights (rendering services to a community, temporary limitation of rights, temporary loss of authorization or license, interruption of activities, etc.) and fines (ranging from R\$50,00 [approximately US\$21,00] to R\$50 million [approximately US\$22 million]). Penalties restricting freedom imposed on individuals may be replaced by those restrictive to rights in some situations.

Scope

Most of the existing federal legislation addresses these aspects of the environment:

1. Water

Businesses operating in Brazil that discharge liquid effluents are subject to federal and state government environmental control. CONAMA Resolution No. 357/2005 sets the standards for effluent, maximum levels of pollutants and the flow regime. Governmental water quality standards differ according to water suitability. Brazil's water quality standards cover a broad range of pollutants and substances, including oil, fecal coliforms, dissolved oxygen and various toxins. The use of specific segments of streams and water bodies are designated by government agencies having jurisdiction over certain water bodies.

Some Brazilian states, including São Paulo, have established supplemental standards that exceed federal minimum standards. In case of conflict, the more restrictive standards shall apply. The state environmental protection agency may impose even stricter standards to a given company if the body of water receiving the effluent is already contaminated, or as a result of peculiar characteristics of the company's processes and wastes.

2. National Policy for Hydro Resources (Federal Law No. 9,433/97)

This law, enacted on January 8, 1997, establishes the National Policy for Water Resources based on the idea that water is a public good and a limited natural resource with economic value. Under this law, the Federal Union will grant the right to use water for some cases (art. 12).

The contribution for the use of water resources may serve to promote the rational use of water and finance programs contemplated under the Water Resources Plans. The same may establish the priorities for the grant of water use rights and the criteria for the collection related to the use of water resources. In addition, this law creates regional river basin committees comprised of public and private parties to manage the water resources and implement their policies and regulations on a regional basis.

Some of the acts considered illegal by this law are: (i) the use of water resources without a proper water use permit; (ii) initiation of an enterprise related to the use of superficial or underground hydro resources, which may alter its quantity or quality, without an authorization from the competent authorities; (iii) the use of water resources in breach of the terms contained in the water use permit; (iv) authorized drilling of a well to obtain groundwater; and (v) provision of false information regarding measurement of the volume of used water. (These violations may be subject to several sanctions.)

The Federal government also created a Federal Water Agency ("ANA")⁷. ANA was created with the task of managing the National Policy for Hydro Resources and controlling federal waters (of Union rivers and lakes).

3. Hazardous waste

According to Brazilian legislation, the generator is responsible for the proper final disposal of hazardous and nonhazardous waste. Federal and State regulations require that the transport of wastes, treatment and disposal (whether solid, hazardous, nonhazardous or medical) must be subject to the prior approval of a state environment protection agency (Federal Regulation No. 053/79). In some cases, companies may temporarily store waste in their facilities under state approval and supervision. In the State of São Paulo, the approval for waste disposal is made by CETESB through a Certificate of Approval, Disposal of Industry Waste, “Certificado de Aprovação - Destinação de Resíduos Industriais - CADRI”, which contains the qualifications of the waste generator, transporter, and site disposal.

Some Bills of Law on Waste Management Policies are under discussion at the State levels. In the State of São Paulo, State Law No. 12.300/06 established the State Policy for Solid Residues. In the State of Rio de Janeiro, the State Law No. 4,191/03 established the State Policy for Solid Residues.

On April 2003, CONAMA enacted Resolution No. 334, which establishes procedures in the Environmental Licensing Process of Business Areas, which received empty pesticides packaging. The resolution set specific definitions on this matter as well as grounds of liability.

There are also specific requirements for hazardous waste classification, inventory and disposal reporting requirements, waste import and export, transport, storage and disposal. The general rule is that hazardous wastes are those that pose potential risks to the environment and public health. Environmental protection agencies adopt the waste classification of ABNT Technical Standard NBR 10.004, which considers as hazardous any waste which is toxic, corrosive, flammable, and reactive. However, other classifications are used by the waste transport regulations. This overlap must be clarified before the regulatory agencies on a case-by-case basis in order to obtain the actual criteria for waste classification.

According to the Federal Environmental Policy, enterprises such as final disposal of wastes and on-site and off-site waste storage sites must be subject to the environmental licensing requirements discussed above. Landfills and hazardous wastes processing and disposal sites are listed as activities that require a

compulsory Environmental Impact Study (“EIS”) for licensing purposes (CONAMA Resolution No. 01/86, Article 2, X). Usually, such activities are also subject to prior municipal approval.

Open burning or storage of wastes is prohibited. In addition, some States established construction, hydrogeological characterization, and groundwater monitoring requirements for waste storage and/or disposal sites. There are also specific requirements for the transport and disposal of used lube oil (CONAMA Resolution No. 09/93), transport and disposal of wastes generated by transport facilities such as airports and ports, and for materials containing PCBs (Joint Ministerial Regulation No. 019/81; Instruction Standard/ SEMA/ STC/ CRS 001/83).

4. Air pollution

Federal laws and some State laws establish air quality and emission standards, taking into account the concentration of atmospheric pollutants that may affect public health, safety and the physical environment. CONAMA Resolution No. 005/89 sets the National Air Quality Monitoring Program (“PRONAR”). Such Program provides for primary and secondary air quality standards and classifies different regions of the country in order to prevent deterioration. Class I areas are those with pristine air quality and which should have no air quality impact, Class II areas must be limited by secondary air quality standards, while Class III regions must comply with primary air quality standards.

CONAMA Resolution No. 03/90 complemented PRONAR by establishing primary and secondary standards for total suspended particulates, smoke, free particulates, sulfur dioxide, carbon monoxide, ozone, and nitrogen dioxide. It also establishes sampling and analysis methods for the pollutants mentioned herein. The States are responsible for monitoring these programs. Some states have enacted their own air quality standards, which cannot be less stringent than the Federal laws.

5. Toxic fertilizers - Biocides

Brazil has also enacted laws dealing with all aspects of the research, production, packaging, labeling, destination, registration, transport, storage, commercial advertising, use, control and inspection of biocides, their components and similar products. Criminal liability is also imposed on those who fails to comply with the legal requirements.

Such activities are regulated by Federal Law No. 7,802/89, which in turn is regulated by Federal Decree No. 4,074/2002 and amended by Federal Decree No. 5,549/05. On June 06, 2000, Federal Law No. 9,974/00 was enacted, bringing many innovations, including the obligation for producers, resellers, and users of biocides to take back the packages of toxic fertilizers used as of May 31, 2002. Therefore, current producers, resellers, as well as users of toxic fertilizers are responsible for the final destination and cleaning of used packages, and subject to the penalties set forth in Federal Law No. 9,605/98 (Environmental Crimes Law).

CONAMA Resolution No. 334/03 establishes the rules for environmental licensing of facilities involved in receiving and final disposing packages of toxic fertilizers, setting forth many requirements aiming to prevent environmental damages.

Brazilian normative rulings regulate the advertising of toxic fertilizers, as well as the use and labeling of mineral fertilizers.

6. Soil and groundwater protection

Brazil's progress in the control of soil and groundwater pollution is one of the country's priorities. The recent discovery of severe cases of soil and groundwater contamination and the stricter enforcement of the legislation by government authorities have raised discussions on whether the country should establish soil and groundwater control and intervention. Until now, the Federal government has issued no references or legislation.

There are no regulations establishing soil and groundwater quality standards in Brazil. However, in Sao Paulo, the Environmental Protection Agency (CETESB) has developed a guidance document defining the draft standards for soil. CETESB initially enacted in 2001 reference values for soil and groundwater, subject to update. In 2005, CETESB enacted an updated list of reference values for soil and groundwater through its Directory Decision No. 195/2005/E. The new values of 2005 improved the Brazilian environmental regulation scheme by comprising 80 compounds in substitution to the values published on October 26, 2001. Most of the state's environmental protection agencies are adopting these values as reference. In addition, these agencies have been adopting the Dutch and the US

EPA on a supplementary basis. For groundwater, agencies also consider the Brazilian Health Ministry's Portaria 518, dated March 2004, establishing the drinking water quality standards.

The new CETESB's values corroborate the concepts of Quality Reference Value – VRQ (regarding the values for clean soil and groundwater), Prevention Value – VP (regarding the values above where there may be damage to the soil and groundwater) and Intervention Value – VI (regarding the values above where there may be direct or indirect potential risks to human health). The prevention values may indicate the need for self-disclosure of the environmental conditions of the site.

If the presence of contaminants exceed the respective reference values for soil and/or groundwater is verified, remediation activities should be performed, considering a criteria that can be verified if possible contamination will endanger the environment, as wells as the company's workers and/or nearby population.

7. Recycling and take back requirements

CONAMA Resolution No. 257/99 establishes that producers or importers of batteries must adopt environmentally-adequate recycling mechanisms and reuse treatment procedures for the disposal of batteries containing lead, cadmium or mercury, exceeding the permitted level. Batteries producers and importers must also label their products in order to inform consumers that they are subject to take back requirements.

CONAMA Resolution No. 258/99 requires producers and importers of tires to collect and properly dispose tires that are no longer in use. According to this Resolution, from 2005 onwards, for every four new (imported or manufactured) tires, the producers and importers must collect five.

Federal Decree No. 3,550/00, enacted on July 28, 2000 establishes take back requirements for packages containing toxic fertilizers.

There are several Bills of Law concerning Waste Management Policies under discussion, at Federal and State levels. Bill of Law No. 203/91 is being deliberated at the House of Representatives and if approved, will establish the federal policy for the collection, treatment, transport and final disposal of wastes within the national territory.

8. BIO-SAFETY

The Cartagena Protocol on Biosafety to the Convention on Biodiversity Protection was ratified in Brazil by Federal Decree No. 5,705/06. Federal Law No. 11,105/05 (regulated by Federal Decree No. 5,591/05) established the new Biosafety Law and provides for the safety and inspection mechanisms for the use of genetic engineering techniques used for the manipulation, cultivation, transport, consumption, commerce, discharge of Genetically Modified Organisms (GMOs), and is aimed at protecting public health and the physical environment. Federal Law No. 11,105/05 expressly prohibits human cloning but allows research with genetic manipulation of stem human cells.

Federal Law No. 11.105/05 states that it is a crime to release GMOs into the environment without observing the rules established by CTNBio and this law. The Federal Law also states as a crime the plantation, production, transport, commercialization, importation, export or storage of GMOs, or its derived products, without authorization or observation of legal provisions. This law also foresees the obligation to pay damage and restore the affected environment. It also contemplates civil and administrative liabilities in the case of environmental degradation or damages to third parties caused by GMOs.

This law created the National Technical Bio-Safety Commission (CNTBio), the authority responsible for, among other things, implementing and updating the National Biosafety Policy and enacting normative instruction regarding issues related to GMOs. The new law also created the National Biosafety Council (CNBS) composed of the Ministries of State which makes the final decision on the commercial approval of GMOs.

Several Normative Instructions have been issued by CTNBio. According to Normative Instruction No. 01/96, all national, foreign or international legal entities developing activities and projects related to GMOs must secure a Biosafety Quality Certificate issued by the CTNBio. The procedure in release such organisms into the environment, as well as the importation, commercialization, transport, storage, manipulation, consumption and discharge of products derived from GMOs are subject to the CTNBIO Normative Instructions.

Federal Resolution CONAMA No. 305/02 regulates the environmental licensing procedure and the Environmental Impact Assessment for the release of GMOs into the environment, the Environmental Impact Study (EIA) and the

Environmental Impact Report (RIMA) on activities regarding GMOs and its by-products. However, according to the new Biosafety Law, the environmental agencies will only have authority to set requirements to merit the approval of certain GMOs if CTNBio asserts such organisms may cause significant negative environmental impacts. Note that this legal provision has been challenged before the Brazilian Supreme Court and has not yet been addressed.

Federal Decree No. 4,680/03 regulates the right to information guaranteed by Federal Law No. 8,078/90 (Consumer Defense Code) on genetically modified food or ingredients intended for human or animal consumption. According to the Decree, any kind of food or by-product containing more than one per cent (1%) of a GMO shall include a warning label on its packages, such as “genetically modified product”, “contains genetically modified ingredient” or “manufactured from genetically modified material”.

According to Federal Ordinance No. 2,658/03, all products containing more than 1% of GMOs must present a specific label containing a highlighted GMO symbol, together with the warning described above.

9. Urban Law and Environment

9.1 Zoning

The federal government (Federal Law No. 6,803/80), several state governments and the most populated cities have enacted zoning laws for the protection of specific areas. These laws restrict the establishment of new industrial plants and the expansion of existing ones in certain areas. Before investing in land for industrial purposes, a buyer must carefully analyze existing land restrictions.

9.2 City's Ordinance

Federal Law No. 10,257/01 (the City's Ordinance Law) refers to the basic policy on the use of urban land. This subject was first regulated by the Federal Constitution (Articles 182 and 183) which determines that the policy of urban development, executed by the Local Public Authority, aims to command the development of the social functions of the city and guarantee the inhabitants' welfare.

With the enactment of the City Ordinance, many legal possibilities for the regulated use of urban land and real estate were implemented. Further to defining a policy for the use of urban land based on its social function, the City Ordinance implemented the Tax for Urban Land (IPTU) progressive in time, the expropriation with the payment of government debt instrument, the special adverse possession in urban real estate, the surface right, the preemption right, onerous grant of the right to build, transfer of the right to build, and neighborhood impact study, among others.

10. Environmental Audits

The practice of environmental auditing in Brazil is relatively new. Given the growth of potential liability for polluting activities and the impact of activities of subsidiaries on their parent companies, environmental audits are becoming increasingly important in determining compliance with environmental laws.

Parallel to voluntary initiatives, legislation has been developed by some states, (including provisions in some state constitutions) and the Federal Government to mandate environmental auditing of some industry sectors. Thus, Federal Law No. 11,284/06, which established proceedings for the management of public forests by private companies, also elected forest audits as an important instrument to guarantee sustainable use of concession areas. According to law, all concessions must be subject to independent forest audits which will be carried out at least every three years and supported by the assignee.

On the state level, Rio de Janeiro initiated these legislative approaches in 1991, followed by Minas Gerais and Espírito Santo and Sao Paulo. This latter law requires periodic environmental auditing of pollution control systems and of activities which pose potential harm to the environment. Other states have also adopted similar legislation. Major cities have also included environmental auditing mandates as part of the local environmental requirements (e.g., Santos-SP and Vitória-ES). Federal Resolution CONAMA No. 306/2002 establishes minimum requirements for environmental audits.

[Revised as of September 2006]

Telecommunications

The privatization of the Brazilian telecommunications sector began in 1995, following liberalization movements in several countries. This took place also because of the understanding that the Federal Government would not be able to make the investments keep up with emerging technology. The privatization was made possible due to an amendment in the Brazilian Constitution (Amendment n. 8 of August 15, 1995), which allowed private entities to invest in and render telecommunications services under licenses granted by the Federal Government. Amendment n. 8 also called for a new law to set the telecommunications' industry general rules, including the creation of a sector-specific regulatory agency (the National Telecommunications Agency - Anatel, created by Law n. 9.472 of July 16, 1997).

After such liberalization, the number of accesses, fixed and mobile, experienced a large increase in Brazil, reaching almost 40 million active accesses for fixed telephony in 2006 and approximately 90 million mobile phones in 2006. In addition, competition has been successfully introduced in several segments of the market, particularly in mobile and corporate services.

Following is a chart outlining the major steps of the telecommunication reform in Brazil:

- Jan. 95 Cable TV Law
- Aug. 95 Constitutional Amendment
- Jul. 96 Specific Law
- Dec. 96 "Band B" cellular telephony auction
- Jul. 97 General Telecommunications Law
- Nov. 97 Establishment of the Regulatory Entity - Anatel
- April 98 General Plan of Grants ("PGO") - Decree-Law No. 2.534
- Jul. 98 Privatization of Telebrás
- Nov. 98 "Mirror" licenses auction
- May. 00 "Small Mirror" licenses auction

- Set. 00 Principles for the implementation of the Personal Mobile Service - SMP
- Mar. 01 SMP licenses auction
- Jan 02 Opening of local telephony to competition
- Jun. 03 Discussion of the renewal of fixed telephony concession contracts
- Apr. 04 New SMP licenses auction
- Dec. 05 Fixed-telephone operators sign new long-term concession contracts
- Jun. 06 Digital TV decree enacted

The Regulators

Anatel, the regulatory authority for telecommunications, is an independent federal entity with administrative and financial autonomy granted by law. It is composed of a council of five commissioners appointed by the President and endorsed by the Senate. The commissioner's term of office is not coterminous with that of the President. One of the commissioners is appointed by the President to act as chairman. The commissioners are assisted by six technical divisions: the superintendence of public services, private services; universal service, radio frequency and surveillance; mass communications services; and the general management superintendence.

Anatel is responsible for granting licenses, signing contracts, inspecting the adequacy of the services, managing the spectrum, mediating conflicts among the players in the sector, punishing providers violating the regulations among other duties, as provided in Law 9.472/97. Anatel is linked to the Ministry of Communications, which, however, has no authority over it. The Ministry is broadly responsible for defining the major policies for the telecoms sector, as well as control over broadcasting licenses. There have been recent disagreements between Anatel and the Ministry of Communications over the attributions of each.

Brazilian Congress has some power over the Agency, derived mainly from its capacity to change legislation and mobilize public opinion. The Congress' interest in the regulatory agency's work is increasing, and thus the creation of further monitoring instruments is expected.

The Judiciary is still unfamiliar with most issues related to telecommunications regulation due to the specificity of the questions at stake. However, this is likely to change gradually, since the number of players seeking judicial measures to protect their interests is growing.

In summary, even in view of the legal and cultural difficulties of implementing an efficient regulatory scheme in Brazil, particularly in the telecommunication sector, progress has been fast, though the institutional framework for telecommunications regulation is still under development.

Licensing

Providers need licenses to engage in any form of telecommunications services. Such licenses are granted by the Federal Government, through Anatel, and may be classified as concession, permission or authorization.

Concessions, contractual in nature, are generally used for services considered to be of public interest (services ensured by the State and in which the obligations of universal service and continuity are present). For concessionaires, prices are controlled and the license is granted for a specific period. The incumbent fixed telephony operators, which are the privatized companies of the former Telebrás system, are the most relevant example of concessionaries in the telecoms sector.

Authorizations are granted for services where public interest is not of critical importance and, accordingly, no universal service and continuity obligations are present. In the case of authorizations, prices are usually not controlled. Most telecommunication services fall today under this class, including Personal Mobile Service (SMP), satellite services, corporate networks, as well as the competitive segment of fixed telephony.

Permissions are used only in exceptional circumstances, and on a provisional basis. Anatel should grant Permissions to fill a temporary absence of service provision.

Telecommunication licenses are most often nonexclusive. The term of the old fixed telephony concessions expired in 2005. The new concession contracts have been in force since January 2006. These new contracts brought some major changes (which are yet to be implemented). These changes are as follows:

- Tariffs will be periodically adjusted by a sector-specific inflation measure.
- Customers will be charged according to the actual minutes spent on the telephone, rather than the number of pulses.
- Operators ought to provide, when requested by the customer, the number, date and hour of any given call.
- A new cost-based methodology will be enforced for the calculation of prices charged for interconnection services.

Authorization terms are in general undetermined, but may also be determined in the Term of Authorization granted by ANATEL, particularly when the use of spectrum is involved. In principle, public bidding is required to grant a concession. In the case of authorizations, public bidding is required only when demand for the license exceeds availability, or else when the use of spectrum is requested. The particular licensing procedures vary case by case, according to the kind of service.

Transfer of the license or of the control of the operator usually requires approval of the regulatory authorities. In the case of concessions, this approval must be prior to closing the transaction. In the case of authorizations, depending on the service at stake, the approval may be prior or after the transaction. Usually, subsequent approval by the antitrust authorities is also required.

Classes of Services

1. Telephony

- a) Fixed Telephony. The Switched Fixed Telephony Service (“STFC”) can be rendered either as a public service (as in the case of the former state-owned companies), through a concession, or as a private service (as in the case of

the competitive operators), through an authorization. The General Plan of Grants (“PGO”)¹ sets forth the general rules governing the introduction of competition among STFC providers.

PGO established the division of the Brazilian territory into four concession areas (“Regions”), three for local and regional long-distance services, as follows: Region 1, North and Northeast; Region 2, South and West; Region 3, the State of São Paulo; and one for domestic long distance and international services, Region 4. One concession per Region was granted to the incumbent fixed telephony providers. In the second stage, authorizations were granted to one competitive operator for each region (the so-called “mirror companies”). The result was a “duopoly”, with two competitors operating per region, which remained until January 2002, when most of the market for local fixed telephony was open to competition.

As a result of the liberalization, the Brazilian market for fixed telephony now accounts for approximately 40 million active accesses. Besides the four large incumbent operators and the four mirror companies, there are dozens of other companies authorized to render STFC. The incumbent operators bear universal service obligations, as established in their concession contracts, while competitive operators are bound mainly to covering obligations and quality of service requirements. Nowadays, entry in the market to render STFC is open, provided that minimum legal, financial and technical requirements are met. Nevertheless, the market lacks competitiveness due to high market power yet held by the incumbents (approximately 95% of the market in their original region of operation). Despite the attempts of the regulatory agency to increase competitiveness, issues such as unbundling and interconnection fees remain significant barriers to new entrants.

- b) Mobile Telephony. To implement the competition in the Mobile Telephony market, the country was divided into 10 areas. In the beginning, there were two companies operating in each area in two different frequency bands. Band A of Mobile Cellular Service (SMC) was granted to former state-owned companies (after which the cellular operation of the Telebrás System

⁸ Approved by Decree-Law No. 2.534, dated April 02, 1998.

was separately privatized), and band B licenses were granted to new competitors. In general, SMC providers operating in bands A and B use TDMA or CDMA technology.

In 2002, Anatel created the Personal Mobile Service (“SMP”, similar to the American PCS), a service intended to progressively replace the SMC. Authorizations to render SMP have been granted since March 2001, and the first provider started its operations in July 2002, using GSM technology. The rules of the SMP are more flexible than those of SMC and all operators are supported by a term of authorization. In October 2002, the rules to be observed by SMC operators willing to migrate to the SMP regime were enacted. Currently, the majority of SMC operators have already migrated to the SMP regime – some remain as SMC licensees because some of their clients are still using SMC spectrum bands.

Brazilian cellular market has always been very competitive. Entry in the market is relatively open, the acquisition of the frequency being the main barrier. Today, only one major player (Vivo) is operating with CDMA technology. GSM-based services, introduced in 2002, have grown rapidly (in fact, GSM is now the leading technology on the SMP system). This may have led Vivo to announce in July 2006 that it was planning to begin GSM operations. In addition, trunking services have recently emerged as potential competitors for mobile telephony. The characteristics of both services are very similar.

2. Satellite

The license to render satellite services is granted by means of an authorization and may only be exploited by a company established under Brazilian laws, with headquarters and administration in the country. The authorization is usually granted for a term of fifteen years, renewable for an equal period.

3. Mass Communications Services.

Pay TV services, regardless of the technology involved (Cable, MMDS or satellite), are generally classified as Mass Communications Services. Each service, according to the technology used, has its own regulation. Licenses are granted for a period of 10 or 15 years, renewable for equal periods. Most of the Brazilian major cities have at least one provider of Pay TV for each technology. Cable TV service is governed by a particular act, Law n. 8.977, of January 6, 1995.

4. Multimedia Communication Service (“SCM”)

SCM is a fixed telecommunications service characterized by the transmission of multimedia information (sound, data, image, etc.) through any technical means. The applicable regulations establish that SCM shall be differentiated from STFC and Mass Communications Services (Pay TV). In fact, SCM is an “all purpose” service with a wide range of applications, with the exception of applications similar to fixed telephony or Pay TV. There are several providers of such service, mainly acting as carriers for other telecommunication companies, or as providers of private network services for corporations.

5. Broadcasting

According to the applicable legislation, broadcasting services are defined as those freely and directly delivered to the public as a whole. It includes Radio and Television broadcasting. Radio and TV networks are currently mostly under private ownership, but some public entities also control a few of them. Broadcasting is not under the jurisdiction of Anatel. It is directly being supervised by the Ministry of Communications. Anatel is responsible for the surveillance over the spectrum.

In December 2002, Federal Law No. 10.610 was enacted to regulate the opening of the Brazilian media market (newspapers, radio and TV) to foreign capital. According to that Law, foreigners and Brazilian citizens naturalized for less than ten years may hold up to 30% of the total and voting capital of Brazilian media companies. Such equity participation must be indirect, through a legal entity organized in Brazil. The percentage also applies to foreign entities that hold equity of any company with indirect interest in any Brazilian media company. Furthermore, editorial and programming managers and directors of such companies must be Brazilian or naturalized citizens for more than 10 years. Government authorities may require companies to provide information and documents that evidence compliance with these rules. Information as to changes in the equity control of the referred-to companies must be relayed to concerned authorities.

6. Digital TV

On June 23, 2006, after a long and fierce debate involving the Brazilian government and the private sector, the Digital TV standard to be adopted in Brazil was finally defined. The chosen standard is the ISDB-T (Integrated Services

Digital Broadcasting – Terrestrial), currently in use in Japan. The idea is that the Japanese standard would be improved with technical enhancements developed in Brazil.

According to the decree promulgated by the President, the standard adopted in Brazil will allow the broadcast of digital signals in both high-definition (HDTV) and standard-definition (SDTV) qualities. Furthermore, one of the declared goals of the Brazilian digital television system is the simultaneous digital broadcast for fixed, mobile and portable receivers. The system will also include interactive features.

Current television broadcasters will be granted an additional channel, therefore assuring that the transition to the digital system will not interrupt the current analogical broadcast. After ten years, all channels broadcasting with analogic technology will be taken back by the government and no analogic broadcasting will be permitted.

7. Internet

The provision of Internet service is not classified as a telecommunications service. It is considered as a value-added service. This means that it is an activity that adds value to a type of telecommunications service. Therefore, Internet Service Providers (ISPs) are not subject to licensing before Anatel.

Broadband Internet access falls within this Multimedia Communication Service category. Therefore, even though the mere ISP does not need any kind of license, the company that operates data transmission lines does need an authorization from Anatel. Brazilian courts are still discussing whether broadband users can be obligated to subscribe to an ISP.

Investments – Forecast to 2006

According to a report published by the U.S. Commercial Service (see footnote), 2005 was a year of recovery for telecommunication companies in Brazil. The national market for that sector grew by 23% over 2004, with sales of products and services reaching US\$35.6 billion.

Business opportunities for 2006 include the prospective opening of the WiMAX market (after the auction of spectrum bands takes place) and the sale

of semiconductors and digital TV related equipment (following the recent decree establishing the Digital TV standard in Brazil). It should be noted, moreover, that the mobile telephony market continues to propel the growth in the Brazilian telecommunication sector.

The Digital Communications Service (“SCD”) may also be a source of further investment. The service is intended to provide broadband access to low-income users and governmental facilities, such as schools, hospitals, universities, etc. According to Anatel’s project, SCD should be partially funded by FUST, the Fund for Universal Service that is currently accounting for circa R\$4 billion (approximately US\$1,6 billion). Anatel and the Ministry of Communications, however, are engaged in a dispute over the control of FUST’s funds. Government authorities are still debating the projects in which this fund should be applied.

Restrictions on Foreign Investment

Decree No. 2.617/98, issued June 6, 1998 established that as a requirement for the rendering of telecommunication services, a company and its immediate shareholders should be located in Brazil and organized under the Brazilian laws. Therefore, foreign investment is allowed, provided that a holding company is established in the country.

Nonetheless, a few restrictions still apply for specific services. The following chart shows the current restrictions (further to those set forth in Decree 2.617/98) on foreign investment in connection with licensing:

No restrictions.	General Rule: Fixed Telephony, Mobile Telephony, and other telecom services
Foreign investment limited to 49% of voting capital	Cable TV
Foreign investment limited to 30% of voting capital	Radio and television broadcasting

Interconnection and Unbundling

Interconnection is currently fully regulated by Anatel. The Agency sets a price cap for interconnection and operators can negotiate lower prices among them. There is currently no obligation to offer cost-based interconnection, but the criteria for operators to reduce prices must be transparent, objective and applied on a non-discriminatory basis. Specific pricing rules are scheduled for 2008, when the well-known LIRC (Long Run Incremental Costs) model is expected to be implemented. Operators must inform the Agency about all relevant information on the conditions for interconnection, in order to guarantee nondiscriminatory access and equal and fair prices. Incumbent operators must offer new interconnection services and new access points, provided that it is technically feasible and reasonably requested. Anatel is currently discussing the implementation of cost-based price criteria for interconnection.

Unbundling obligations, however, though generally established by the applicable law, were not specifically regulated until May 2004. In the previous context, unbundling agreements were solely subject to negotiations between the parties involved. Now, following an Anatel decision, the incumbent operator must accept the so-called line sharing, and it can only charge for this service previously defining maximum prices.

Anatel is also involved in further detailing the regulation on the so-called “industrial exploration of dedicated line”, which relates to the leasing of network elements by the incumbent operators to companies interested in using their long-distance networks. Anatel currently regulates the maximum prices that companies with significant market power (i.e., the incumbents in their respective concession areas) may charge for this service. In 2008, Anatel expects to implement the LIRC model to fix these maximum prices.

Competition Matters and Restrictions to Cross-ownership

In order to ensure a competitive environment, the Brazilian regulators are very concerned about cross-ownership in the telecommunications sector. As a general rule, companies that operate a service in a given region are prohibited from

obtaining additional licenses or acquiring companies to operate the same service in the same region. The same restriction applies to any shareholder that has actual control over a certain provider.

If the operator fails to comply with this cross-ownership requirement, it will be subject to several penalties, including, at worst, the cancellation of the license. To ensure the compliance with cross-ownership rules, the Law establishes that any market concentration among telecommunication services providers must be submitted to Anatel's approval, followed by the scrutiny of the antitrust agency (the Brazilian Competition Commission - CADE).

Specifically regarding fixed and mobile telephony, the transfer of licenses or of control will be permitted only if it promotes the compatibility of the geographic areas of operation and the consolidation of company control within a Region.

Anatel and CADE work jointly to prevent anti-competitive practices involving the provision of telecom services. The development of competition in the telecom market in Brazil and the growing number of operators point towards an increasing role of anti-trust legislation in the sector.

Fees and Taxation

All telecommunications services are subject to fees collected by Anatel for licensing and inspection based on a number of factors, such as the specific type of service, the number of stations, the range used in the spectrum, among other things.

The main tax for telecommunication services is the sales tax ("ICMS"), collected at the state level and due at a rate varying from 25% up to 30% of the total price charged for the service, depending on the state. The taxable event is broadly defined to include the generation, transmission, retransmission, repetition, amplification or reception of communications of any nature.

In the case of ISPs, there still is an intense debate on whether the ICMS or the Municipal Sales tax ("ISS") should be applied. There are court decisions supporting both understandings, and a definitive position is still to be reached. However, a recent case made its way to the Brazilian Supreme Court of Justice and the decision is likely to establish the final understanding on the matter. According to the Court's decision, ISPs are not subject to the ICMS tax.

Furthermore, there are also specific taxes applicable to telecommunications services providers. FUST (as mentioned earlier) is a fund for universal service and is charged on the basis of 1% of the provider's monthly gross income. FUNTTEL is a fund to technology development in telecommunications and is levied on the basis of 0,5 % of the provider's gross income. FISTEL is a surveillance fee levied according to the size and complexity of the network.

Trends

- Anatel is currently involved in the implementation of the "third generation" of mobile phones, the 3G. The prospective regulatory framework, however, is not quite clear yet. In July 2006, Anatel presented to the public a draft regulation opening new spectrum bands that should be used by companies providing third generation services.
- Another important subject whose debate is just beginning in Brazil relates to the MVNOs (Mobile Virtual Network Operators). Brazilian telecommunication rules do not regulate this kind of service yet, but Anatel should eventually address the issue in the future.
- Wi-fi broadband Internet access has been under Anatel's scrutiny as well. Following the increasing number of wi-fi spots and users in Brazil, Anatel has started to regulate this broadband segment. For example, the agency enacted in 2005 some rules concerning wi-fi providers operating on the 2,4GHz spectrum.
- Brazilian regulation is not very clear on Voice over IP. Despite the lack of a regulatory framework, Brazil corporate and personal VoIP users are quickly growing. While some VoIP providers operate without a specific authorization from Anatel, other companies opted to operate under a general authorization granted by the agency. Anatel is particularly concerned with companies that use VoIP to transmit calls originating and finishing in ordinary telephone handsets (rather than a computer).
- Anatel is planning to sell spectrum bands to companies interested in providing WiMAX services in Brazilian cities. The auction in which these bands will be sold, however, has sparked a fierce contest between Anatel and

the Ministry of Communications. (Anatel understands that, in order to promote competition, the incumbent operators could not bid for spectrum bands in their respective concession areas.)

[Revised as of September 2006]

Public Bids, Concession of Public Services in Brazil and Public and Private Partnerships

This chapter provides an overview of the applicable regulations regarding public bidding procedures in Brazil, the rules on concession of public utility services for a number of industries, such as oil and gas, power, roads, mining, water sewage, waste treatment, and telecommunications, among other things, and the recent introduced rules on Public and Private Partnerships.

Public Bidding and Administrative Contracts

In Brazil, the Government must contract or purchase by means of public bidding. According to the 1988 Federal Constitution, Article 37, XXI, “except for cases specified in law, public works, services, purchases and sales shall be contracted by means of public bidding, that ensures equal conditions to all bidders, with clauses that establish payment obligations, maintaining the effective conditions for the proposal, according to the law, which shall only allow requirement of technical and economic qualifications essential to secure performance of the obligations.”

In compliance with the constitutional requirement, the general rules on public bidding and administrative contracts for works, services (including advertising), purchases, sales and leases within the jurisdiction of the Federal Government, States, the Federal District and Municipalities, including their direct administrative bodies, autonomous government entities, public foundations, state-owned companies, mixed-capital companies and other entities (the “Public Administration”), are set forth under Law No. 8.666 of June 21, 1993, as amended by Law No. 8.883 of June 8, 1994 and subsequent statutes (“the Bid Law”). Without prejudice to the aforementioned, according to Brazilian Constitutional Amendment No. 19, of 1998, state-owned companies and mixed-capital companies that are engaged in the exploration of economic activity of manufacturing or commercialization of goods or rendering of services are allowed to have a simplified bidding process, provided that the said process is created by law and conforms with the main principles set forth in Law 8883/94.

Public Bidding

The Bid Law does not define “public bidding”. Nevertheless, case law is quite unanimous in understanding that public bidding is a procedure by which the Public Administration is bound to evaluate – pursuant to objective and previously established guidelines and criteria – the largest number of alternatives possible for any given contract to be entered into with a private enterprise or individual.

Administrative Contracts

According to the Bid Law, administrative contracts are “any and all contracts between the Public Administration and private entities in which there is a binding arrangement – stipulating reciprocal obligations – regardless of the name given thereto” (Article 2, Sole Paragraph). These contracts are governed by the Bid Law, the principles of administrative law, and, as a supplement, by the general theory of contracts and private law. However, due to the legal status of such contracts, the Public Administration has certain prerogatives on which we shall elaborate later.

Administrative Contracts for the Concession/Permission of Public Services – Legal Background and Concept

Not only the “routine” administrative contracts, however, are subject to the Bid Law. Concession and Permission contracts, “which involve both the Public Administration and third parties, shall necessarily be preceded by bidding”, pursuant to Article 2 thereof. Article 124 of the Bid Law further establishes that provisions, which do not conflict with specific legislation on the matter, shall also apply to contracts for the permission or concession of public services.

The Bid Law is, therefore, in line with the provisions of Article 175 of the 1988 Federal Constitution, which states that the Public Administration is responsible for providing public utility services, either directly or through concession or permission, which will always be preceded by public bidding. The Constitution further establishes that the law shall provide for:

1. the regime for public utility service concessionaires and permission holders, the special nature of their contract and of extensions thereof, as well as the conditions of forfeiture, control and termination of the concession or permission;
2. the rights of users;
3. tariff policy;
4. the obligation of maintaining adequate services.

On February 13, 1995, specific legislation on this matter was enacted under No. 8.987 (the “Concession Law”), as amended by Law No. 9.074 of July 95, that concerns especially the Power’s Contracts. For purposes of the Concession Law, the following definitions apply (Article 2):

1. **Public Service Concession.** The delegation for the rendering of services, made by the granting authority (the Federal Government, the States, the Federal District or the Municipality in which the service is located), by means of a competitive bidding process, to the legal entity or consortium of companies that demonstrates capacity for performance thereunder, on its own account, and for a definite period;
2. **Public Service Concession Preceded by Execution.** The total or partial construction, maintenance, remodeling, extension or improvement of any works of public interest, delegated by the granting authority, by means of a competitive bidding process, to the legal entity or consortium of companies that demonstrates the capacity for execution thereof, on its own account, in such a way that the investment of the concessionaire is remunerated and amortized by means of the exploration of the service or work for a definite period;
3. **Public Service Permission.** The delegation (on a temporary and revocable basis) by means of a competitive bidding process, of the rendering of public service, made by the granting authority to the individual or legal entity that demonstrates the capacity for performance thereof on its own account.

General Rules of the Bid Law – An Overview

The lawful accomplishment of any administrative contract (including concession and permission contracts) is subject to prior bidding in most of the cases.

Pursuant to the Bid Law, the general rules on the matter are:

1. the bidding is classified into different categories [competitive bidding (*concorrência*), “price request” (*tomada de preço*), invitation to bid (*convite*), contest (*concurso*) and auction (*leilão*)], and adopted depending on the estimated value of the contract. For concession contracts, the competitive bidding is the suitable category;

Since the end of 2000, the Federal Government has created a new category of bidding for the acquisition of common goods and services: the “Pregão”. This bidding category is currently regulated by Law No. 10.520 of July 17, 2002. This new category provides for a procedure simpler than the standard public bid procedure, with the presentation of the proposal before the eligibility stage, and without the need to present a guarantee of the proposal, etc. Decree No. 3697/00 which regulates such Law, in its definition of “common goods and services”, lists the products and services, which may be acquired by the Pregão category of public bid. It includes, among other things, services of equipment maintenance, general utensils (except computer goods), office supplies, and the like. Recently, the Federal Government enacted Decree n° 5.450/2005 determining that all biddings for the acquisition of common goods and services have to use this category.

2. the bidding process may be waived in a number of specific situations (which are described in Article 24). The process may also be deemed inapplicable, if competition is not feasible, for instance:
 - (i) in the event of a single existing supplier; or
 - (ii) in case of hiring technical services from professionals or companies of known expertise (Article 25).
3. any interested party meeting the minimum qualification requirements (Articles 27 to 33) of legal capacity, technical and economic/financial qualification, as well as tax or fiscal standing, may take part in a competitive bidding (see next page).

4. the request for proposals or “Edital” is the instrument by which the conditions of the transaction to be entered into with the Public Administration are made public. Pursuant to Article 40 of the Bid Law (as confirmed in the wording of Article 18 of the Concession Law), the Edital must, among other details, indicate:
 - a. the object of the bidding;
 - b. deadlines and conditions for execution and performance of the contract, as well as for delivery of the contracted object;
 - c. penalties for noncompliance;
 - d. the executive project, if any;
 - e. conditions for taking part in the bidding and form of presentation of proposals; and
 - f. criteria for the judgment of proposals.

Other important rules contained in the Edital may include:

1. judgment procedures;
2. contractual principles, rules on contract execution, amendment, performance, non-performance and termination;
3. administrative sanctions;
4. definition of crimes and relevant penalties; and
5. procedures for administrative appeals.

Eligibility to Bid – Fundamental Principles

In principle, any entity able to meet the preliminary qualification requirements may submit a proposal. The Bid Law provides in Article 3 that “the bidding is designed to guarantee the observance of the constitutional principle of equality, as well as to select the proposal that is most advantageous for the Administration. The bidding shall be processed and analyzed strictly in accordance with the basic

principles of legality, impersonality, morality, equality, publicity, administrative probity, abidance by the public invitation notice, objective judgment, and other related items.”

The Law expressly forbids public agents from allowing the Edital to contain any conditions that may restrict or hinder in any way the competitive nature of the bidding. In this sense, preferences or distinctions between bidders based on nationality, domicile, or other conditions irrelevant to the object of the bidding are forbidden. Establishing differentiated treatment between domestic and foreign companies is not allowed either (Article 3, Paragraph 1). However, the Bid Law does set a preference criterion for Brazilian companies of national capital, where there is a tie between proposals (Article 3, Par. 2). The Concession Law, in turn, gives preference to proposals presented by Brazilian companies (Article 15, Paragraph 4).

The Concession Law also maintains these guidelines by reiterating that concessions shall be necessarily preceded by a bidding procedure which is in accordance with the terms of the applicable legislation. The previously mentioned principles of legality, morality, publicity, and judgment, in accordance with objective criteria, and compliance with the invitation notice are also to be observed in the case of concessions (Article 14).

The Bid Law and the Concession Law convey one of the most important principles in Brazilian Public Law, i.e., the “equality among bidders”. Nevertheless, this does not prevent the Public Administration from establishing minimum participation requirements, provided that they are necessary to guarantee the performance of the contract, the security and perfection of the work or service, the regularity of the supply, or the meeting of any other public interest, in accordance with the provisions of the Bid Law.

Concession Contracts – Stability and Preservation of Financial & Economic Equilibrium

In any contract entered into with the Public Administration, one of the major concerns of the contracting party is the stability of the contract. Certainly, this is the case of concession contracts, which require a considerable amount of investments. In this respect, it is advisable to analyze some of these issues.

A contract is a typical Private Law arrangement, based on the parties' free will to contract. Nevertheless, when used by the Public Administration, the contract assumes a publicist nature, in view of the extraordinary powers of the Public Administration. This is the reason administrative contracts are governed by Public Law principles, partially derogated by Private Law rules (on a supplementary basis).

A number of characteristics can determine a contract to be of an administrative nature. However, the essential feature that typifies an administrative contract is the presence of the Public Administration as one of the parties with supremacy of power over the private contracting party. Another crucial element of administrative contracts is the underlying public interest, on which we shall comment further.

Due to the legal status of this type of contract, the Public Administration has the prerogatives of:

1. modifying the contract unilaterally to adjust it in accordance with public interest;
2. terminating the contract unilaterally, should public interest make it inconvenient, as well as in those material cases established by the law;
3. monitoring performance under the contract;
4. applying penalties for total or partial non-performance; and
5. as a precaution, in case of essential services, taking temporary possession of personal property, real estate and services comprised by the object of the contract.

The private contracting party's rights are also clearly assured by the Bid Law. In case of termination for causes attributable to the Public Administration (as listed in items XII to XVII of Article 78 of the Bid Law), for which the contracted party has not contributed, the latter shall be reimbursed for the losses actually incurred, without prejudice to the devolution of guaranties, payment for works executed up to the termination date and payment of stoppage costs. (Article 79, Paragraph 2 of the Bid Law). The private party has also assured under the Brazilian Federal Constitution and under the Bid and Concession Laws, the right to revise the prices or tariffs contracted whenever necessary to restore or preserve the original conditions of its proposal or the so-called "financial and economic equilibrium" between the obligations and the respective compensation.

Concession Contracts – Termination

The events of termination of a concession are regulated by Articles 35 to 39 of the Concession Law. To this effect, the concession shall be terminated if one of the following - occurs:

1. expiration of the contractual term;
2. expropriation;
3. forfeiture (by the Public Administration, by means of administrative process, for failure by the concessionaire);
4. rescission (by the concessionaire, by means of a lawsuit, for contractual breach by the Public Administration);
5. annulment (for any illegality in the bidding which precedes the concession); and
6. bankruptcy or termination of the concessionaire.

Termination of the concession entails reversion to the granting power of all “revertible assets, rights and privileges”, as established in the contract and in the original public invitation notice. In this event, the Public Administration is also entitled to take over the service and relevant premises in order to allow its continuity (Article 35, Paragraphs 1 to 3).

Pursuant to Article 35, Paragraph 4, however, termination for completion of the contractual term or expropriation obliges the granting power to proceed with prior surveys and appraisals in order to determine the indemnification due the concessionaire for the investments made.

Upon completion of the contractual term, the ownership of the concession assets must be reverted to the Government, along with the reimbursement by the Public Administration of the non-amortized or non-depreciated amount of the investment made in assets, subject to reversion. (Article 36)

The concessionaire is also entitled to indemnification in case of expropriation. For purposes of the Concession Law (Article 37), expropriation is considered to be the takeover during the term of the concession, for public interest reasons,

upon enactment of an authorizing law to that effect. The indemnification due the concessionaire in this case is also to be calculated in accordance with the criteria mentioned in Article 36 of the Concession Law.

In case of forfeiture, the concessionaire is also entitled to indemnification, from which any penalties or contractual damages due to the Public Administration are to be deducted. In this event however, termination is only effective after the applicable administrative procedure, in which full defense is allowed. Pursuant to the Concession Law, forfeiture of the concession may be declared by the granting power in the following events:

1. services rendered in an inadequate or deficient manner;
2. failure by the concessionaire to comply with contractual, legal or regulatory rules regarding the concession;
3. if the concessionaire halts or contributes in the halting of the services, except for acts of God or *force majeure*;
4. loss of concessionaire's economic, technical or operation conditions to maintain the concession;
5. failure by the concessionaire to comply with penalties imposed by the granting power, or with notice to rectify the rendering of services; or
6. if the concessionaire is convicted for tax evasion. (Article 38)

The Concessionaire's Rights and Duties

In addition to the rights and obligations described in the previous topics, the Concession Law dedicates Article 31 to the description of the concessionaire's duties as follows:

1. rendering adequate services;
2. keeping up-to-date inventory and registration of the concession assets;
3. keeping the Public Administration and users informed of the management of services;
4. allowing free access to inspection;

5. carrying out expropriations and establishing rights-of-way, pursuant to the contract and relevant bid invitation;
6. taking care of and insuring the concession assets; and
7. collecting, investing and managing the financial resources necessary for the rendering of the services.

For purposes of the Concession Law, adequate services are those which meet conditions of regularity, continuity, efficiency, security, modernity (in technology, equipment, premises and relevant maintenance, as well as enhancement and enlargement of the service), generality, courtesy in providing, and at a moderate rate, of tariff. (Article 6)

With regard to the concessionaire's rights, however, the Concession Law does not show the same level of systematization. Nevertheless, we list below some of the most important rights of a public service concessionaire in Brazil:

1. Article 9: maintenance of the service tariff in accordance with the criteria established in the Concession Law, the contract and the relevant bid invitation;
2. Article 13: establishment of differentiated tariff levels, given the technical characteristics and specific costs of each segment of users;
3. Article 14: abidance on the part of the Granting Power by the previously mentioned principles of the bidding (which precedes the granting of the concession);
4. Article 25, Par. 1: outsourcing activities that are complementary, accessory or inherent to the concession (keeping, however, its original responsibility for losses and damages caused to the Public Administration or to any third parties);
5. Article 26: granting sub-concessions within the limits of the contract, and if authorized by the Public Administration;
6. Article 28: offering the rights emerging from the concession in guarantee to financing agreements (provided that the operation and continuity of the service is not hindered);

7. Article 39: terminating the contract in case of breach by the Public Administration;
8. being indemnified for the investments made, as previously described, as well as being granted full opportunity of defense in administrative procedures brought against the concessionaire.

Public and Private Partnership Contracts

On December 31, 2004, Law no.11.079, the ruling on Public and Private Partnerships (“PPP”) was published. With this new law, the Government intends to obtain approximately US\$13 billion in private investments, both local and foreign, in basic infrastructure, particularly in transportation and sanitation.

The new regime for transferring the execution of public services to the private sector is applicable to and may be used by all entities of the direct public administration, as well as by the special funds, governmental agencies, foundations, public companies and other entities controlled by the Federal Government, States and Municipalities.

In addition to the common concession of public services, as exposed in the previous chapter (per Law of Concession of Public Services which created Law no. 8.987/95), two other modalities of public services concession were created. These are the sponsored concession (*Concessão Patrocinada*) and the administrative concession (*Concessão Administrativa*). Sponsored concession is the concession of public service and public work in which the remuneration of the private partner involves, besides the tariffs paid by the users of the services and the complementary remuneration provided by the public partner. Administrative concession is the services agreement in which the Public Administration is the direct or indirect user (e.g., building, operation and management of public buildings), even if it involves execution of works or supply and installment of goods.

The difference between the new modalities of concession and the common concession, which continues to exist according to the rules mentioned in the precedent items, consists exactly of the payment and remuneration to the private entity by the Public Administration. Therefore, when the concession does not involve any remuneration from the Public Administration, it will not be a PPP contract, but a common concession.

The referred-to law also establishes limits for contracting Public and Private Partnerships; it is not allowed to execute contracts

- (i) involving less than R\$20 million;
- (ii) with a final term of less than 5 years; or
- (iii) whose purpose is solely the supply of workers, the supply and installment of equipment, or the execution of public works or construction.

The administrative contract regulated by PPP Law shall have terms compatible to the amortization of the investments effectuated by the private partner – never less than five (5) and more than thirty-five (35) years, including a possible extension. For the execution of these contracts, the creation of a Specific Purpose Company will be demanded, with the exclusive scope of implementing and managing the PPP projects.

The greatest innovation brought by this new legislation is the creation of a two billion-dollar Guarantor Fund (composed of good shares of public and private companies, real estate, money, etc.). This fund will guarantee that the public sector will duly pay its obligations, assumed by hiring the private sector. Its assets will serve to guarantee possible collection action filed against the contracting Public Partner.

Another point that must be stressed is the possibility of use arbitration in case of dispute resolutions that may arise in a PPP contract. This is the first time that a Law permits the Public Administration to proceed and participate in arbitration procedures.

Considering that the main intention of the government in creating the PPPs is to allow and to rush the construction of the works that are necessary for the sustained development of the country, it is necessary to include new mechanisms in the public bidding proceedings to make it quicker, allowing the quick resolution or mitigation of the deficiencies on Brazilian infrastructure. One of the new mechanisms is the provision that the project will only be up for bid after the issuance of the preliminary environmental licenses which are considered as the main obstacle to current infrastructure projects.

In addition to the Federal Legislation, the Brazilian States have also enacted State Laws aimed at local projects (that do not have the interference of the Federal Union). These Laws create new forms of guaranties, such as the creation of public companies with assets that offer warranties. These are also responsible for signing and managing the contracts. The main States that have already published its own laws are São Paulo, Minas Gerais, Santa Catarina, Bahia and Rio Grande do Sul.

[Revised as of September 2006]

Insurance

The insurance business in Brazil is regulated mainly by the 2002 Civil Code and by laws passed in 1966 and 1967, which delegated regulatory authority to

- (i) the National Council of Private Insurance (*Conselho Nacional de Seguros Privados*), known as “CNSP”, a body composed of government authorities, responsible for establishing the principal rules for the organization and operation of insurance companies in Brazil;
- (ii) the Superintendence of the Private Insurance (*Superintendência de Seguros Privados - SUSEP*), known as “SUSEP”, which is CNSP’s regulatory and implementing agency, which is subordinate to the Ministry of Finance, responsible for regulating, monitoring compliance of, and imposing penalties involving insurance, pension and capitalization companies, and insurance, pension and capitalization brokers, in Brazil; and
- (iii) the Brazilian Institute of Reinsurance (IRB - Brasil Resseguros S.A.), formerly Instituto de Resseguros do Brasil, known as “IRB Brasil Re” or “IRB”, a mixed-capital entity, responsible for carrying out all reinsurance operations in Brazil. IRB’s monopoly is expected to end soon and a bill of law is pending to be voted in the Brazilian Congress.

Insurance rules and regulations are basically divided into two categories, life insurance and non-life insurance. Health insurance is regulated separately.

In 1992, the Ministry of Finance and SUSEP implemented an Insurance Guideline Plan liberalizing certain legal restrictions. Such guidelines were adopted to deregulate insurance operations while maintaining strict control of financial solvency. The goal was to promote competition in the insurance market; to end the monopoly over reinsurance; and to open the insurance sector to foreign investments. SUSEP has deregulated insurance premiums and eliminated pre-approval requirements for the adoption of new insurance products by adopting the “file and use” system. In September 1996, SUSEP also eliminated the requirement that insurance premiums be indexed. The mechanisms for verifying the solvency and reserves of insurance companies were thus strengthened.

CNSP and SUSEP are currently restructuring its inspection and solvency legislation, adapting them to a risk-based capital model, in conformity with the guidelines of Solvency 2.

Incorporating an Insurance Company in Brazil

An insurance company in Brazil must be organized in the form of a stock corporation (*sociedade anônima*) and may not conduct any business other than insurance. Pursuant to the insurance licensing rules contained in CNSP Resolution No. 136/05, insurance companies should be managed by individuals with proven professional experience in the insurance area, holders of university degrees and those who have never been charged with a criminal offense. Finally, except if an insurance company becomes insolvent and its assets are insufficient to pay 50% of its creditors, or if the company or its administrators commits a bankruptcy crime, an insurance company shall not be subject to the Brazilian general bankruptcy and reorganization legislation.

Licensing Requirements

There are no restrictions on foreign equity and voting interests in Brazilian insurance companies. To obtain a license authorization for operation, the shareholders must first send a pre-filing consultation addressed to SUSEP's Superintendent outlining the capital structure and other information. After SUSEP's pre-approval, the petitioners must submit to SUSEP a licensing application with the information and documents required by SUSEP Circular No. 260/2004, including a statement of intent indicating the types of insurance and the locations where it intends to operate.

Minimum capital

Upon incorporation and prior to filing the licensing application, the founding shareholders must pay in cash or in cash equivalent (Brazilian federal bonds) at least fifty percent (50%) of the company's stock capital. The cash portion must be deposited in a special bank account, pledged to SUSEP until the granting of the license. The remaining fifty percent (50%) of the stock capital must be paid in within one year from the issuance of the operating license and its publication in the official newspaper.

According to CNSP Resolution No. 73/2002, in order to operate either property and casualty insurance or life insurance, the company must have a minimum capital, whose computation provides for a fixed portion and a variable portion.

In either life or non-life insurance, the company's fixed portion of the capital is R\$1,200,000. The variable portion of the capital, depending on the relevant areas of operation, varies from R\$120,000 to R\$2,400,000, by area of operation.

The variable portion for Rio de Janeiro is R\$1,800,000 and R\$2,400,000 for São Paulo. The variable portion required for all Brazilian regions is R\$6,000,000. To operate property and casualty insurance or life insurance exclusively in all Brazilian regions, the insurer must have a capital of R\$7,200,000. For a composite license (life and nonlife) to operate in all regions, the insurer's required minimum capital is R\$14,400,000.

Pre-filing for Corporate Acts

According to CNSP Resolution No. 121/05 and SUSEP Circular No. 298/05, SUSEP must pre-approve any transactions of incorporation, merger, spin-off, sale or any other form of corporate restructuring of insurance companies, capitalization companies and open pension entities, as well as the transfer of direct or indirect corporate control, or any other act which may imply in the change of the decision-making control of insurance companies, capitalization companies and open pension entities deriving from: (i) legal transactions entered into by the controlling shareholders; (ii) shareholders agreement; or (iii) acts of any individual or business entity, or group of persons representing a common interest.

Operating Requirements

Every six months, insurance companies must prove compliance with the mandatory solvency ratios imposed by CNSP Resolution No. 8 of 1989, as amended by CNSP Resolution No. 55 of 2001, which requires the company to have "net assets"⁹ sufficient to cover:

1. 0.2 times the premiums issued during the preceding 12 months, and

⁹ Corresponds to the company's accounting net worth, *plus* revenues received of future accounts; *less* (i) the value of direct/indirect equity holdings in other insurance, pension, capitalization and reinsurance entities, HMO's, banks and other financial institutions, refreshed by equity pick-up, (ii) 50% of direct and indirect equity holdings in affiliates and controlled entities with different activities, refreshed by equity pick-up, (iii) non-matured expenses paid in advance, (iv) accelerated expenses, (v) tax credits resulting of income tax losses and negative basis of social contribution, (vi) trademarks and patents rights, (vii) rural real properties, (viii) deferred assets, and (ix) rights and obligations of foreign branches' operations. (CNSP Resolution 85/2002).

2. 0.33 times the annual average of retained claims for the preceding 36 months, taking into account all premiums collected, except for individual life and retirement insurance.

Operating and technical limits exist according to the level and type of insurance coverage provided.

The insurer's premiums collected for the past 12 months must be equal to or higher than a pre-established portion that varies from 0.3% to 3% of the insurance company's net assets, depending on various factors. In some circumstances, the retention limit may be as low as 0.075% of the insurer's net assets, so as to enable start-up companies to reinvest funds.

The retention limit precludes insurance companies from undertaking a single risk in excess of three percent (3%) of the company's net assets. The company's net assets is the company's net worth plus gains accrued on stock investments not realized and all revenue received related to future accounts; less the value of any direct or indirect participation (net worth value) in other companies with similar activity and/or pension funds, all expenses due in the future and paid in advance and all accelerated expenses. Offices (headquarters and branch offices) of the insurance companies, as well as those of its brokers, are subject to periodic inspections by SUSEP officials for the review and audit of financial statements. Insurance companies are subject to further review by an official council of actuaries, irrespective of whether an actuary has previously approved the company's financial statements contracted by the company itself.

Brokers

Insurance brokerage provisions of Law 4,595 and Decree-law 73 define "insurance broker" as the intermediary legally authorized to solicit and market insurance contracts, putting together insurance companies and prospective customers.

Normative rules of the CNSP and SUSEP set forth that, save for authorized agents and direct marketing sales, the attraction of potential customers for new insurance coverage may be performed only by brokers licensed and registered with SUSEP, or by a *preposto* (delegate) of the broker duly empowered by him and also registered with SUSEP.

Only licensed and registered brokers may receive insurance applications, certify the corresponding policy and collect commissions through physical receipt of cash or bank account deposits. A broker may pay his *preposto* a portion of the commission received. The *preposto* is required to receive insurance training at an official insurance academy and obtain a registration with SUSEP.

Reinsurance

Pursuant to Decree-law No. 73/66, the Brazilian Constitution initially reserved reinsurance activities for the exclusive domain of the Government, namely, the government-controlled entity IRB-Brasil Re. The 13th Constitutional Amendment (passed on August 21, 1996) provides that reinsurance activities may also be carried out by nongovernmental entities pursuant to regulation in the form of a normative law (*lei complementar*) governing the authorization of private companies to enter this field.

In December 1999, Law No. 9.932 was published in the official newspaper. It transferred IRB-Brasil Re.'s regulatory and enforcement attributions and duties over reinsurance to SUSEP and delegated the authority to regulate reinsurance to CNSP – which enacted several rulings in connection therewith – but an equitable injunction granted by the Brazilian Constitutional Supreme Court in connection with a lawsuit for unconstitutionality declaration suspended the effectiveness of Law 9,932/99. In October 2002, the Supreme Court finally confirmed the injunction and finally declared Law 9,932 unconstitutional.

The foreign reinsurance companies that have opened a Representative Office in Brazil and executed an agreement with IRB-Brasil Re have preference to receive, in reinsurance, portions of the risks retroceded by the IRB-Brasil Re.

IRB-Brasil Re has issued Circular PRESI-018/2002 containing the General Rules of Reinsurance and Retrocession (“NGRR”), whose provisions are applicable to all participants of reinsurance transactions in Brazil. Its clauses (clauses 101-597) provide for matters pertaining to reinsurance transactions, such as those regarding retention capacity, reserves and recovery advancements; adjustment and settlement of claims; and provides for other matters not directly related to the reinsurance agreement, such as the duties to communicate court proceedings of interest to the IRB-Brasil Re.

While establishing those General Rules of Reinsurance and Retrocession, the Directorate of IRB-Brasil Re revisited dozens of procedures affecting the commercial relation with insurance companies in the process of acceptance and cession of risks. One of the novelties refers to the interest rate embedded in the premium's fractioning. Previously, the IRB-Brasil Re used to follow the interest rate for premium installments set forth in the underlying insurance agreement. The fractioning is limited to seven installments of equal value. (See also IRB's Circular PRESI 6/2003 for the terms and conditions of reinsurance premium installments and applicable rates.)

According to the NGRR, the reinsurer must give its prior approval for the acceptance of insurance products requiring reinsurance. IRB has 15 days from the receipt of the proposal to accept or deny the facultative reinsurance.

Insurance companies with risks reinsured by the IRB must give notice to the IRB, within 72 hours, of the existence of any court proceedings related to a claim, and must report to IRB, within 60 days, any settlement of claims made pursuant to a court decision.

The NGRR requires that any dispute between the reinsurer and the reinsured be submitted to an arbitration proceeding under the rules of the Rio de Janeiro Arbitration Court (Câmara de Mediação e Arbitragem do Rio de Janeiro).

[Revised as of September 2006]

Privatization

This chapter will focus on current federal rules that govern the Brazilian National Privatization Program, i.e., Law No. 9.491, of September 9, 1997, and Decree No. 2.594, of May 15, 1998. These rules refer to the sale of companies, including financial institutions, controlled directly or indirectly by the Federal Government, as well as the transfer to private initiative, of the rendering of public services provided by the Federal Government or its controlled entities. At the end of this chapter, one shall also briefly describe the public-private partnership program, which tends to be the instrument of choice of the current administration to attract private investment for infrastructure projects.

According to federal law, privatizations may be carried out under one of the following structures:

1. sale of controlling shares;
2. initial public offer;
3. capital increase, with total or partial waiver or transfer of government's subscription rights;
4. sale, transfer or lease of assets and real estate;
5. dissolution of companies or partial suspension of activities;
6. grant of concession, permit, or authorization for public services.

To date, most privatizations have been made in the form of transfer of shares of the capital of state-owned companies and/or the granting of the right to render public services.

In addition to the federal privatization program, each state and municipality has the power to establish the rules for its own program and, therefore, the privatization of state- or city-owned companies is made considering specific local rules. Such rules will not be analyzed in this chapter.

Eligible Companies

A state-owned company is eligible for privatization only upon its inclusion in the privatization list ("PND"). A company is included in the PND by a Presidential

decree upon recommendation of the National Council for Privatization (“CND”). If a company needs to be restructured prior to or in preparation for its privatization (e.g., merger, spin-off, amalgamation) it may also need congressional approval for such restructuring.

The most important economic activities under state control are either already privatized or currently undergoing some level of privatization in Brazil, including the following:

1. generation, transmission and distribution of electric energy and gas;
2. petrochemicals;
3. highways, railroads, sea and flight transportation;
4. telecommunications;
5. ports, airports, aerospace infrastructure, road construction, dams, canal locks, dry docks and containers;
6. financial institutions;
7. sanitation, water treatment and supply, waste treatment; and
8. mining and metallurgy.

Relevant Entities

The major federal governmental entities for privatizations are the CND and the Banco de Desenvolvimento Econômico e Social (“BNDES”). CND is the deliberative body of the federal privatization program. The coordination and control of privatization functions fall under the guidance of the Secretary of the Ministry of Planning. The main attributes of the CND are as follows:

1. to coordinate and supervise the execution of the National Privatization Program;
2. to recommend to the Brazilian President the inclusion or exclusion of public companies in the National Privatization Program;
3. to approve the sale structure of each privatization project and to make the necessary corporate and financial adjustments;
4. to determine the destination of funds collected in each privatization; and

5. to approve the reports and studies in connection with the privatization.

BNDES has also an active role as the Privatization Fund Manager, providing administrative and operational support to the CND, retaining consultants and specialized services as necessary for carrying out privatization process, as well as contacting stock exchanges and securities authorities, among other duties.

Until now, most privatization projects have been carried out by means of auctions at the Brazilian stock exchange (BOVESPA and BOVERJ), following Law No. 8.666, of June 21, 1993, which regulates Article 37, XXI of the Federal Constitution and establishes the rules for the public bidding process. This federal act was later amended by Law No. 8.883, of June 8, 1994, and Law No. 9.648, of May 27, 1998, which established requirements for, *inter alia*, bid invitations, methods, payment, and guarantee forms. There is already a new bill of Law regarding public bidding procedures under scrutiny by the Congress.

Typical Procedure

Although the privatization processes vary, a typical case normally involves the following stages:

1. The state-owned company is listed in the PND by recommendation of CND;
2. BNDES selects the consortium of advisors that will prepare the privatization documents. The consortium presents the documents (executive summaries, due diligence reports, requests for proposal, share purchase agreements, and the like) which, upon CND's ratification, are then published;
3. Public hearings are usually held to clarify the privatization procedure and documents;
4. Site visits and data rooms are generally available to interested investors who are conducting their own due diligence investigations;
5. Investors present their qualification packages and bid bonds for the bidding;
6. The bidding takes place, usually as a public auction at a stock exchange; and
7. Closing takes place a few days after the bidding.

[Revised as of September 2006]

Employment Relations

The basic rules governing the legal relationships between employers and employees in Brazil are set forth in the Federal Constitution and in the Brazilian Labor Code (*Consolidação das Leis do Trabalho*).

Brazilian Labor Code generally regulates all aspects of a labor relationship, and is supplemented by labor and social security laws and collective bargaining agreements. In Brazil, all claims involving labor matters are decided in labor courts.

Employment Relationships

The Brazilian Labor Code defines “employee” as an individual rendering services to a company or individual on a regular basis, under the direction of such company or individual, for compensation. Brazilian courts consistently recognize the existence of an employment relationship whenever those elements are evidenced, whether or not a written employment agreement exists.

Please note that in Brazil, the admission of an employee requires the filling out of certain blank spaces in the employee’s Employment Booklet (*Carteira de Trabalho* which is similar to a passport held by the employee) to identify the employer and the date of admission, salary (generally per month) and function to be discharged by the employee. Similar annotations should be made in the company’s books. The execution of a separate written employment agreement is not required by Brazilian law and is rather used as a matter of convenience to deal with certain matters.

If a worker is not under the direction of the employer (for example, an independent sales representative), the relationship between such person and the company would be subject to general Brazilian civil and commercial contract rules, and not to the Labor Code or other labor regulations. Nevertheless, Brazilian labor courts are generally sympathetic towards individuals who claim an employment relationship, essentially shifting the burden of proof to the presumed employer.

Economic Group Concept

Per Article 2 of the Brazilian Labor Code, when one or more companies are under the same direction or control of another company, they are jointly held

liable to labor code violations. Therefore, the registration of the employee in only one company and the fact that the employee renders services only to this company does not exclude the joint liability of the company's economic group.

Brazilian Labor Rights

Under Brazilian law, an employee is entitled to the following labor rights (in addition to what may have been agreed upon in a written employment agreement):

- annual mandatory salary increase, at the percentage rate set forth in either the Collective Bargaining Agreement executed by and between the respective Employees' union and the Employers' association;
- annual Christmas bonus (frequently called "13th month salary") in an amount equivalent to one monthly compensation;
- annual vacation of 30 calendar days, coupled with a vacation bonus equal to 1/3 of the employee's monthly compensation, in addition to the officially declared holidays during the year;
- Severance Fund (*Fundo de Garantia Por Tempo de Serviço* or "FGTS") to be funded by the employer by depositing 8.5% percent of the employee's monthly compensation in a special bank account of the employee at the Federal Savings Bank (*Caixa Econômica Federal*). The amounts deposited in such fund may be withdrawn by the employee upon his/her retirement as well as in very special cases, such as the acquisition of a house and, particularly, termination of employment by the employer, without cause; and
- Other payments as set forth in the Collective Bargaining Agreement.

Profit Sharing

The Federal Constitution enacted in 1988 provides that Brazilian employees have the right to the profits of their employer. Such right may not be treated as remuneration. Law No.10.101, of December 19, 2000, regulates the procedures and requirements that must be met by Brazilian companies to implement a plan for the employees' share in the profits or results of the company. Provided that the requirements set forth by the law are met, the amounts paid to the employees under the plan will not be treated as compensation.

Pursuant to the law in force, there are no minimum pre-established amounts payable to the employees. All that is required is that employer and employees (represented by the employees' committee or employee's union) enter into an agreement setting forth: (i) clear rules in connection with the right of employees to receive a share of the company's profits or a certain payment upon achieving certain results; (ii) objective conditions for the employees to achieve such a right; (iii) the dates of payment – the maximum to be paid on a semiannual basis; and (iv) the term of the agreement and the dates for revision thereof.

The participation of the labor union – or one of its representatives – is required to render the plan valid.

Probation Period

Under Brazilian labor laws, the employer may hire an employee for a probation period, in order to observe if this employee has the appropriate skills. The probation period shall cover 90 days, or the period set forth in the respective Collective Bargaining Agreement, provided that such term is agreed upon in writing.

Term of Employment

Employment agreements are generally in force for an indefinite term. As an exception, an employee can be hired for a probation period of up to 90 days, provided that such term is agreed upon in writing (as indicated above). The employee may also be hired under a fixed-term agreement to perform services or activities of a temporary nature (in which case, the employment is valid for only two years).

Part-time Employment

Part-time work can be contracted up to a maximum of 25 hours per week. The compensation of the part-time employee must be proportional to that of another employee working full time (i.e., 44 hours per week) in the same function.

Termination and Severance

The concept of at-will employment is recognized in Brazil. Both the employee and the company may terminate the employment relationship at any time for any reason, with or without cause.

Termination of an employment relationship in Brazil is a rather formal matter, as Brazilian law requires the filing of a Termination Form with the proper labor authorities, even if the employee resigns. The payment of severance indemnities and the execution of the Termination Form must take place in the presence of a representative of the employee's union or the Labor Department, except if the employment relationship has lasted less than one year.

Brazilian employees are always entitled to severance pay in case of termination. The amount involving severance and labor rights will depend on whether the employee has been terminated for cause or not, and whether the termination is effected by the employer or the employee. (The Labor Code thoroughly describes the legal causes for employee termination.)

The basic and routine severance payments in case of termination without cause are the following:

- Compensation due until the day of termination;
- Accrued vacation leave credits based on one month's compensation per year of employment. When termination occurs before a full year is completed, vacation shall be calculated on a pro rata basis;
- Vacation bonus, equal to one-third of one month's compensation. In case of *pro rata* vacation, the bonus shall be calculated based on the amount actually due to the employee for vacation;
- Accrued Christmas bonus (also called "13th month salary") equal to 1/12 of the employee's monthly compensation per month of employment (or a fraction thereof at least equal to 15 days), starting January 1st to the day of termination;
- The severance notice indemnity, equivalent to one month's compensation of the employee, except if the notice is given at least 30 days in advance. Note that when notice of dismissal is given, a 30-day period is given within which

the employee is (i) permitted to work two hours less than normal working hours, or (ii) relieved from work within seven days, under the assumption that he/she would use such time to find another job; and

- Fifty percent (50%) of the balance of the employee's Severance Fund bank account (FGTS).

Social Security

In Brazil, the employer is required to contribute to the Social Security Department, on a monthly basis, in an amount equivalent to twenty percent (20%) of the gross salary of each employee plus other social costs. These social costs may vary from 5,4% to 8,8% depending on the company's activities. The employee must also individually make the payment of social security contribution of between 7.65-11% over gross monthly salary (limited to R\$2,668.15), which is withheld by the employer from the employee's earnings.

Outsourcing

Outsourcing or independent contracting by the company of a service or activity to a third party must be carefully carved out of the typical employment relationship. Although there are no specific laws in this regard, the outsourcing has been well accepted by the labor Courts when the outsourced activity is not linked to the core business of the contracting company.

Outsourcing of services related to the main activity of the company is always somewhat problematic because labor courts may construe the existence of an employment relationship between the company and those individuals performing the services, even if they are employed by and registered in the payroll of another company, the service provider company.

Unions

The creation of a union for both employers and employees are dealt with in the Federal Constitution. In Brazil, there are unions representing the employees and unions representing the employers. Their respective unions represent employers and employees in matters involving collective employment relations. The employees,

regardless of their affiliation to the union, are entitled to the labor benefits that are granted in the Collective Bargaining Agreement negotiated between the employers and the employees union for that specific economic category.

Unions are organized following certain business activities that involve, for instance, commercial transactions, metallurgy, chemical production, and the like. The union representing a given company shall be that of the main activity of the company.

Employers and employees must pay annual contributions to their respective unions. The employer's contribution is generally paid in January of each year, based on the number of employees and on the capital of the company, and on the employee's contribution which is equivalent to an employee's one-day salary generally paid in March. The employers and employees' unions representing a given business activity negotiate the terms of a collective agreement dealing with salary increases and several other issues to be in force within one year. If no agreement is possible, the parties can avail themselves of mediation services of the Labor Department or the Labor Courts.

This memo provides employers with general information about employment relationships. It should not be taken as advice regarding labor of any particular matter. No client should act or refrain from acting on the basis of any matter contained in this report without professional advice on the facts and circumstances at hand.

We will be glad to provide you with any requested additional information on this matter.

[Revised as of August 2005]

Real Estate

In Brazil, Law 10.406, dated January 10, 2002 (the “Brazilian Civil Code”), generally governs the rights associated with immovable properties.

The Brazilian Civil Code divides assets in two different categories: movables (i.e., personal) and immovable assets. The immovable assets category encompasses the land, together with its surface and all accessions, construction and improvements, attached to or forming part of the land, the air space above the land, and the subsoil. Waterfalls and mines and products from the subsoil are considered separate assets from the land. The exploitation of mineral resources and hydroelectric power are subject to authorization from the federal government, according to the Brazilian Federal Constitution.

In addition, although certain assets are physically moveable (i.e., machinery and equipment used at industrial plants and ships), they are construed under the Brazilian Civil Code as immovable assets, by means of legal fiction.

The rights related to immovable assets (including real estate properties) are divided into the right of possession and the right of ownership.

The right of possession is the personal right arising from the ownership or dominion over the property.

The right of ownership is the right of an individual to use, enjoy, and dispose of the property as a whole or solely its superficial part, i.e., for plantation or construction. The concept of disposing the superficial part of the land, or land surface law (*direito de superfície*), was recently brought into our regulation by means of the Civil Code (articles 1369 to 1377). Basically it requires a definite term and a public deed duly registered in the relevant Real Estate Registry; does not allow works at the underground level, except if it belongs to the nature of the concession; could be remunerated or free of charge; entitles the land recipient to the right of first refusal in case of the sale of the property; and once terminated, owner obtains full title of the land, construction or plantation, regardless of indemnification, in case the parties have not agreed thereto otherwise.

Some restrictions may apply to the right of ownership, such as in cases of creation of easements, expropriation of the property by government authorities, or in case

of the creditor's composition, insolvency or bankruptcy. Restrictions may also apply in case of national interests. In addition, the use of the property may be subject to zoning and construction limitations, as provided under the relevant laws.

Several individuals or entities may be jointly entitled to the right of ownership in relation to the same property. In this case, a co-ownership (or condominium) will be deemed construed among the different owners, and each of them will be entitled to all rights associated to a specific ideal portion (*fração ideal*) of the property. The costs associated to the maintenance of the property (i.e., housekeeping and security) are shared among the members of the condominium.

In case of a condominium, any of its members may exercise all rights of ownership, except those that are not consistent with the indivisibility of the property. Therefore, the entire property cannot be transferred without the concurrence of all the condominium members. Brazilian Law 4.591, dated December 16, 1964, generally governs the rights and obligations attributed to the condominium members.

Brazilian laws restrict the acquisition by a foreign individual or entity of a property within any rural area larger than three *módulos rurais*. The size of a *módulo* rural varies, depending upon the region and the state in which it is located. Other restrictions may apply in case of properties located in areas considered areas of national security.

Restriction to foreigners is not applicable in case of collateral of rural properties, provided that actual title to the property is not transferred and only a security interest is created for the benefit of the foreign creditor.

Acquisition of properties

In Brazil, the transfer of title to a property occurs only upon registration of the act that transferred it, or the rights thereto, with the relevant Real Estate Registry. For registration purposes, every property must be registered at the specific Real Estate Registry having jurisdiction over the area in which the property is located. Such registration is made under a specific enrollment (*matricula*), which lists all data in respect of the property, including details of its current and former ownership, the existence of liens and mortgages and easements.

Typically, a property is transferred upon the registration of the purchase and sale agreement executed by the buyer and seller at the *matricula* of the property at the

Real Estate Registry. As a general rule, for purposes of transferring the title, the purchase and sale agreement must be executed in a public format, by means of a public deed executed before a notary public.

A property may also be acquired by inheritance, *usucapio* or accession (the enlargement of the land arising from the conveyance of parcel of the soil through natural causes). In these cases, the court order granting the rights over the property is the instrument to be registered at the Real Estate Registry.

Provided that the *matrícula* of the property is the relevant document which details the relevant data of the property, any document, act or instrument which may modify, extinguish, transmit or create rights related to the property, must also be registered. Hence, to be perfected and valid before third parties, a mortgage or a lien over a property shall be registered.

The transfer of a property is subject to the payment of the Real Estate Transfer Tax (ITBI). The ITBI rates vary in accordance with the city in which the property is located, and is calculated upon the actual value of the transaction or the appraised value of the property, whichever is higher. According to the Brazilian Federal Constitution of Brazil, the ITBI does not apply to real estate transfers pursuant to corporate mergers or contributions to paid-in capital.

Real estate lease

Law 8.425, dated October 18, 1991, and, supplementary, the Brazilian Civil Code, govern urban real estate lease agreements for both residential and commercial purposes (including the lease of premises located in shopping centers).

Under the law, among other obligations, upon execution of a lease agreement, the landlord must deliver the leased property to the tenant in a condition of use for the purposes set forth under the agreement. Moreover, landlord is liable for any damage or defects in the leased property prior to the lease and also, if that is the case, for the payment of the extraordinary condominium fees charged during the lease term (in other words, for the expenses necessary to maintain the structure and safety of the real estate).

Tenant shall be responsible, among other obligations, for

1. the correct and timely payment of the rent, charges, duties and ordinary condominium fees, if that is the case;

2. the use of the real estate according to the purpose set forth in the agreement; and
3. returning the real estate at the term of the lease in the same condition tenant has received it, except for the regular wear and tear.

Furthermore, tenant shall give landlord notice of any damage or defect, which falls under the landlord's obligation to repair.

The parties are free to negotiate contractual conditions with respect to the term of the lease, rent amounts and improvements. Notwithstanding, in Brazil it is typical to provide that tenant shall be responsible for the payment of the property tax levied on the leased property during the term of the agreement.

According to price adjustment rules today in force, the rent may be monetarily adjusted for inflation every 12 months as of its effective date. Rent should be adjusted in accordance to one of the various Brazilian inflation indexes (i.e., the IGP - General Prices Index - published by the Fundação Getúlio Vargas). Regardless of the annual adjustment for inflation, according to Article 19 of Law 8245/91, after three years of the lease term, any of the parties may request in court a revision of the rent, in order to adjust it to the market price.

When a lease exceeds five years, tenant has the right to apply for an automatic renewal of the lease (if some conditions are met, i.e., maintain the intended use of the leased premise), and cannot be removed from the leased property unless for specific defaults. The rent for the lease extension is negotiable, and if the parties cannot agree on the amount, the rental amount will be determined in court.

In case of sale of the real estate, tenant has the legal right of first refusal; otherwise, such right would not be waived under the agreement. If tenant does not exercise such right, and only

1. if the agreement establishes that it shall continue in force in case of sale thereof to third parties,
2. if the agreement was entered for a fixed term,
3. if it is registered before the relevant Real Estate Registry, then the new owner of the real estate must comply with the agreement.

The law also provides for different types of collateral that landlord may request as a security for tenant's compliance with the agreement (unless the rent is paid in advance):

1. a deposit equivalent to the maximum of three rents to be deposited to a savings account during the term of the lease;
2. a personal guarantee extended by an individual or an entity (it may be replaced by a bank guarantee); or
3. an insurance policy covering compliance of tenant's obligations.

The law does not permit more than one type of collateral for the same lease agreement.

During the term of the lease, landlord may not demand repossession of the property except

1. if by mutual agreement with tenant;
2. in case tenant breaches any contractual or legal obligation;
3. if tenant does not pay the rent and other duties, or lastly,
4. if urgent repairs in the leased property have been ordered by a public agent.

Tenant, however, has the right to terminate the lease before its term, subject to the payment of the contractual penalty established by the parties on a *pro rata* basis, taking into account the elapsed term of the agreement. In the event of an expropriation of the property by public authorities, landlord and tenant may both seek indemnification from the expropriating authority, unless otherwise provided under the lease agreement.

Lease in shopping centers

In Brazil, shopping centers are incorporated under a condominium arrangement ruling

1. the use of private areas (or the leased premises); and
2. the access of every shopkeeper or tenant to its common areas.

Thus, subject to the comments above with respect to the obligations regarding ordinary and extra ordinary condominium fees, both landlord and tenant shall bear the costs for the maintenance of the common areas of the center. Public restrooms, parking areas, entrances, exits, sidewalks, ways, alleys and trash bins should always be kept in good and safe condition.

Furthermore, there are four typical documents associated with the landlord-tenant relationship, with regard to the ruling of the use of private and common areas in a shopping center:

1. the Declaratory Deed of General Norms Regulating the Function, Utilization and Lease of the Shopping Center;
2. the Internal Rules of a Shopping Center;
3. the Shopkeepers' Association rules; and
4. the specific lease between the landlord and the individual tenant.

The Declaratory Deed sets forth the development, construction and basic operating rules for the center. It is a registered document with the incumbent Real Estate Registry. Provided the Declaratory Deed is registered, it has priority over all subsequent documents, such as individual leases, whether such leases are registered or not. If there is a conflicting clause between the Declaratory Deed and the individual lease, the clause in the Declaratory Deed takes preference, unless the lease specifically references the conflicting clause and specifies the difference. It is not sufficient to state in the lease a general clause, that in case of conflict between the two documents, the lease clause applies. Each conflicting clause must be specifically enumerated and referenced in the lease for the clause to apply.

[Revised as of September 2006]

Oil & Gas

On October 5, 1988, the Brazilian Congress enacted a new Federal Constitution which states that the research and exploration of crude oil, natural gas and other fluid hydrocarbon materials, as well as the refining, importation, exportation and transportation of these products through pipelines or by sea constitutes a monopoly of the Federal Government (Article 177). The Brazilian Constitution, Article 177, 1st paragraph, at that time, determined that the Federal Government would be prohibited to assign or grant any type of participation, in kind or in money, in the exploration of crude oil and natural gas. Only the concessions already granted remained in force.

However, on November 10, 1995, Constitutional Amendment No. 9 was approved by the Brazilian Congress, which modified the original text of Article 177, 1st paragraph, in order to allow the Federal Government to contract private or public companies to perform the activities described in the paragraph above, in accordance with a law to be enacted.

On August 6, 1997, the Brazilian Congress enacted Law No. 9,478 (the “Petroleum Law”), which established the Brazilian energy policy, regulated activities related to the oil monopoly and created the National Council on Energy Policy and the National Oil Agency (*Agência Nacional do Petróleo* or ANP), linked to the Brazilian Ministry of Mining and Energy.

The Petroleum Law confirms the Federal Government monopoly over crude oil, natural gas and other fluid hydrocarbon materials existing in Brazil. It also states that the activities listed in Article 177 of the Brazilian Constitution may be exercised by companies governed by Brazilian law, with head office and administration in Brazil through concessions or authorizations.

The concessions for oil companies imply the obligation to explore oil and gas, at its own account and risk, and in the event of success, to produce oil or natural gas in the respective blocks. After their extraction, the ownership of these products will be conferred on such companies, together with all charges relative to the payment of due taxes and the corresponding legal or contractual participation shall also be borne by the concessionaire company.

The Petroleum Law revoked Law No. 2,004, of October 3, 1953, which created the Brazilian state controlled oil company (Petróleo Brasileiro S.A. - PETROBRAS).

Petrobras is now regulated by the Petroleum Law which authorizes Petrobras to either act alone or associated with other companies for the purposes of conducting the activities listed in the Petroleum Law. The performance of these activities may be implemented through consortiums between Petrobras, either as the lead company or not, and domestic or foreign companies, provided the latter has incorporated a Brazilian subsidiary with head and administrative office in Brazil.

According to the Petroleum Law, Petrobras would have the right over each of the fields that were in effective production on the initial date of the Petroleum Law. Furthermore, the blocks where Petrobras has achieved commercial discoveries or advanced expressive investments in exploration, should be kept by Petrobras to proceed with the exploration and development work for three years, provided that Petrobras should demonstrate its financial capacity to the ANP.

The Brazilian government will be compensated for the concessions granted under the Petroleum Law by means of:

- signature bonus;
- royalties;
- special participation; and
- payment for occupation or retention of area.

The exploration and production of gas fields are also regulated by the ANP and must follow the same regime applied to oil corresponding activities. Gas processing and transportation of natural gas are activities that require a prior authorization from the ANP. However, as opposed to oil by-product distribution, pipeline gas distribution is governed by state monopoly regulations.

Public bids

According to this new legislation, it is now possible for any Brazilian company¹⁰ to bid for a concession to explore crude oil or natural gas.

¹⁰ Foreign companies may also participate in the bidding process. However, if a foreign company is awarded with a concession, it must organize a Brazilian subsidiary or branch, with a head and administrative office in Brazil, prior to executing the respective concession agreement.

The public bids must comply with the following procedures: (i) pre-qualification of the bidding companies; (ii) qualification of such companies; (iii) the ANP's publication of the bid notice, which must contain all bidding rules; (v) examination of the bids; (vi) registration of the tender; and (vii) signature of the Concession Agreement.

In December 1999, ANP announced Brazil's first oil and gas exploration and production licensing round. Only offshore blocks were bidden and on September 30, 1999 this round was brought to a successful conclusion.

In the Second, Third, Fourth, Fifth and Sixth Bid Rounds (December 2000, October 2001, June 2002, August 2003 and August 2004) both onshore and offshore blocks were offered and successfully awarded.

In October 2005, the Seventh Bid Round, held by ANP, established a new model of bidding, during which both exploratory risk blocks and "marginal fields" (as further explained below) were offered. This new method has increased the number of companies interested in the bidding process. The Seventh Bid Round was a great success and, therefore, awarded 251 exploratory risk blocks and 16 Marginal fields' blocks.

In conclusion, the past rounds were successfully concluded with a total of 610 blocks awarded, which corresponds to approximately 300 thousand km² - or 4,7% of the 29 Brazilian sedimentary basins. During these Rounds, the ANP collected over R\$3 billion in signature bonus (US\$1,43 billion) and the 56 players involved shall invest about US\$20,1 billion in their respective Minimum Exploration Programs until 2009.

The following table provides for the areas which were offered and/or awarded during the last Bid Rounds:¹¹

		Round 1	Round 2	Round 3	Round 4	Round 5	Round 6	Round 7	
								Exploratory risk	Marginal Fields
Offered Blocks		27	23	53	54	908	913	1.134	17
Awarded blocks	Offshore	0	12	27	11	81	64	41	0
	Onshore	12	9	7	7	20	89	210	16
	Total	12	21	34	21	101	154	251	16

¹¹ Source: <http://www.brasil-rounds.gov.br> (May 2006).

The table below depicts the number of companies which took part in each phase of the ANP bidding procedures:¹²

	Round 1	Round 2	Round 3	Round 4	Round 5	Round 6	Round 7	
							Exploratory risk	Marginal Fields
Expression of Interest	58	49	46	35	18	30	53	113
Payment of Participation Fees	39	48	44	33	14	27	47	92
Qualified companies	38	44	42	29	12	24	46	91
Bidding companies	13	27	26	17	6	21	32	53
Winning companies	11	16	22	14	6	19	30	16

Marginal Fields and Second Bid Round of Inactive Areas. As mentioned above, the Petroleum Law provided for certain transition rules concerning Petrobras, which stated that the ANP would ratify Petrobras' rights over each field where it was producing oil and gas on the initial date of such law, and the blocks where Petrobras has achieved commercial discoveries, or advanced expressive investments in exploration. In that sense, in August 1998 the ANP ratified Petrobras' rights over these blocks by means of the execution of several concession agreements¹³ related to 282 fields either in production or development phases. Several fields were not claimed by Petrobras within the deadline established by the Petroleum Law and those have been at ANP's disposal ever since.

Since 1998 several fields have been returned to the ANP and have become known as "returned fields" or "marginal fields". In that sense, the ANP has included 17 of these marginal fields in the Seventh Bid Round (11 in the State of Bahia and 6 in Sergipe), which have been named "Inactive Areas containing Marginal Accumulations".

After the success of this First Bid Round of Inactive Areas containing Marginal Accumulations, the ANP decided to organize periodic rounds for such areas with a schedule separated from the regular Bid Rounds in which blocks with exploratory risks are offered.

¹² Source: <http://www.brasil-rounds.gov.br> (May 2006).

¹³ Although there was no bidding process, this was nicknamed "Round 0".

ANP intends to encourage the investment of small and medium companies in the production of oil and natural gas in marginal onshore fields, where the infrastructure for treatment and transport of oil and natural gas is already installed.

On June 29, 2006, ANP held the Second Bid Round for Marginal Fields or Inactive Areas. Eleven of the fourteen areas which were offered by ANP and were awarded to nine different companies measured 220.8 km². It is important to notice that 55 companies have demonstrated interest in the areas offered, and 30 have actually made offers. The total amount of Signature Bonus were around R\$ 10.7 million. The expected investment on these areas is valued at R\$ 24 million for the evaluation programs in the next two years.

Eighth Bid Round. In May 2006, the ANP announced that the Eighth Bid Round will occur in October 2006. It is expected that the rules and the judgment criteria to be observed in connection with such round will not substantially differ from the ones adopted for the Bid Round¹⁴.

Evaluation criteria. During the past bidding rounds, the formula used by the ANP for the judgment of each bid presented took into account only two (2) factors: (i) signature bonus, equivalent to eighty five percent (85%); and (ii) concessionaire's commitment to acquire local goods and services ("Local Content"), equivalent to fifteen percent (15%).

According to the rules defined by the ANP for the Fifth and Sixth Bid Round the weight of the Local Content has increased from fifteen percent (15%) to forty percent (40%), of which fifteen percent (15%) refer to the exploration phase and twenty-five percent (25%) refer to the development phase. The minimum work program, which is now proposed by the concessionaire, based on the "Work Units" criteria defined by the ANP, weights thirty percent (30%), and the signature bonus' weight has been reduced from eighty-five percent (85%) to thirty percent (30%).

The Seventh Bid Round has established different rules for the evaluation of the bids related to the exploratory risk blocks and the marginal blocks when concerning the offers evaluation method. For the exploratory risk blocks the evaluation took into account the following factors: (i) signature bonus, equivalent

¹⁴ However such rules will be established by the Public Bid Invitation, which has not been published.

to forty percent (40%); (ii) Local Content¹⁵, equivalent to fifteen percent (20%), of which five percent (5%) reserved to the exploratory phase and fifteen percent (15%) to development phase and (iii) minimum work program, equivalent to forty percent (40%).¹⁶

Government Takes

The signature bonus is the amount offered by the bidders during the public bidding promoted by the ANP, and its minimum value is established in the bid invitation. This government takes shall be paid until the date of signature of the Concession Agreement.

Royalties are a financial compensation that must be paid by the concessionaire, on a monthly basis, in Brazilian currency, as of the date at which the concessionaire starts producing crude oil and natural gas in a given field. Such amounts vary from 5% to 10% of the oil and natural gas production.

The special participation is an extraordinary financial compensation due from the concessionaires only in cases of large volume of production or high profitability, payable, on a quarterly basis, in connection with each field of a given concession area. The concepts of “large volume” and “high profitability” are regulated by means of Decree No. 2,705, of August 3, 1998 and vary in accordance with number of years in production, area location and quarterly production volume.

The payment for the occupation or retention of the area was created by the Petroleum Law and was further regulated by Decree No 2,705/1998. The bid invitation and the Concession Agreement will provide for the amount payable for the occupation or retention of the concession area, to be assessed at each calendar year.

¹⁵ Important to highlight that the ANP establish minimum percentage amounts for the Local Content for each block varying, according to the water depth and the phase in progress, from 37% to 70% in the exploration phase and 55% to 77% in the development phase. The maximum percentage of Local Content ranges from 55% to 80% in the exploration phase and from 65% to 85% in the development phase.

¹⁶ Please note that the factors for the evaluation of the bids related to marginal fields are the following: (i) signature bonus, with a weight of twenty five percent (25%); and (ii) initial work program, corresponding to seventy five percent (75%) of the bidder's grade. Although Local Content is not one of the criteria considered in the bidder's grade, ANP has requested a minimum Local Content percentage offer equivalent to seventy percent (70%).

At the criteria of ANP, a part of the payments listed above, and a variable percentage between 0.5% and 1.0% of the oil or natural gas production shall be paid to the surface holder.

Environmental aspects

Brazilian environmental policy is implemented at federal, state and municipal levels. The Brazilian Institute of the Environment and Natural Renewable Resources (Instituto Brasileiro do Meio Ambiente e dos Recursos Naturais Renováveis - IBAMA) is an agency submitted to the Brazilian Environmental Ministry and is responsible for implementing environmental policy at the federal level. States and some of the biggest Municipalities have their own environmental agencies.

The environmental policy is regulated by Law No. 6,938, of August 31, 1981, which also defines the jurisdiction of each environmental agency, and the environmental licensing proceedings. CONAMA – The National Council of Environment – Resolutions No. 23/94 and No. 237/97 regulate and establish special procedures for environmental licenses. The first one is specifically related to the environmental licensing proceedings of the activities of exploration, drilling and production of crude oil and natural gas and the second one provides for the general licensing proceedings, requirements, also listing operations and facilities that must obtain environmental licenses, included therein drilling wells and production of crude oil and natural gas operations. These licenses are the following:

- Operating License for Seismic Activities;
- Pre-drilling License;
- Pre-research Production License;
- Installation License; and
- Operating License.

Environmental licenses are normally issued upon certain conditions, which the applicant must comply with; otherwise, the license loses its validity.

As one of the steps of the licensing proceedings, it is important to highlight the preparation of environmental studies prior to the issuance of the environmental licenses above mentioned. The complexity of the environmental study to be

prepared and the term for the issuance of environmental license may vary depending on where the exploration activities are to be performed. Activities performed close to conservation units, for example, require more complex investigation and therefore longer time period for IBAMA to review the application.

Furthermore, in some cases or upon request by the Public Attorney's Office, the environmental agency may require that a public hearing is called in order to discuss the report of the environmental study. The rules concerning public hearings are stated in CONAMA Resolution No. 9, of December 3, 1987.

According to CONAMA Resolution No. 350 of July 06, 2004, activities connected with the acquisition of maritime seismic data and activities performed in transition zones, which comprise both offshore and onshore areas, must be conducted only upon the issuance of the Seismic Research License (*Licença de Pesquisa Sísmica – LPS*), by IBAMA, after hearing the competent environmental State agencies, if applicable.

In 1999, IBAMA created an office exclusively responsible for oil and nuclear activities – the *Office for the Licensing of Petroleum and Nuclear Activities - ELPN*. ELPN is located in the State of Rio de Janeiro, where the majority of the crude oil production takes place. The ELPN is responsible for analyzing and approving license applications related to the oil industry – which includes the analysis of the applicable environmental studies.

Important statutes are Law No. 9,605, of February 13, 1998 and Decree No. 3,179, of September 21, 1999, which defines environmental crimes and establish the applicable penalties. The Federal Environmental Crimes Law (Law No. 9,605/98) regulates criminal and administrative liability for environmental damages. It imposes severe administrative and criminal penalties on individuals and legal entities that cause environmental damages, including officers, partners, members of the board of directors, managers and employees of legal entities (Article 2). Under the Environmental Crimes Law, companies that operate without the necessary licenses or in disagreement with environmental legal requirements may be subject to penalties such as suspension of the activities, fines and imprisonment of the responsible individuals (Article 60). Fines may range from R\$50.00 to R\$50,000,000.00.

In addition to these statutes, there are several other supplementary rules regarding mandatory environmental audits, publication of environmental licenses in the Official Gazette, implementation of Environmental Impact evaluation, among other things.

ANP Ordinance No. 3 of January 10, 2003 (“ANP Ordinance No. 3/03”), establishes procedures for the communication of operational accidents and the accidental release of pollutants to be adopted by concessionaires and companies authorized to perform upstream activities, as well as companies authorized to carry out storage and shipping activities for oil, its by-products and natural gas.

Law No. 9,985, of July 18, 2000, published in the Official Gazette on July 19, 2000, which regulates article 225, first paragraph, items 1, 2, 3 and 7 of the Brazilian Constitution, creates the Brazilian Conservation Unit System, among other provisions.

Law No. 10,165 of December, 2000 (“Law No. 10,165/00”) creates the new Environmental Inspection and Control Fee, to be paid to IBAMA by all individuals and legal entities, which perform potentially polluting activities and are users of natural resources. Fines may vary, depending on the polluting potential, level of use of natural resources, and size of company, and its payment shall be performed on a quarterly basis.

Midstream and downstream activities are also subject to environmental licensing proceedings, usually conducted by the state environmental agency with authority over the place in which such activity will be developed. However, there are federal rules that apply to the environmental licensing proceedings of these activities, especially in case such activities are developed in federal waters or comprise the territory of more than one State. In this sense, CONAMA Resolution No. 273, of November, 2000, published in the Official Gazette on January 8, 2001, establishes that the location, construction, installation, modification, enlargement and operation of distributors, gas station, retail system installation, and floating gas stations shall depend on the prior licensing by the environmental agency with authority over the area of the business without detriment to other licenses legally required.

CONAMA Resolution No. 269, of September 14, 2000, published in the Official Gazette on January 12, 2001, establishes that the production, importation, selling and use of chemical dispersants for operations to deal with spills of oil and its by-

products at sea, depend upon the prior registration of the product with IBAMA. The use of chemical dispersants on leaks, spills and discharges of oil and its by-products at sea shall observe the criteria established in the regulation attached to this Resolution (Article 2).

CONAMA Resolution No. 281 of August 12, 2001, sets forth the forms and models for publication of formal requests and related forms to apply for the issuance or renewal of licenses for projects and operations carried out in accordance with Article 2 of CONAMA Resolution No. 01/86, including among other things, ports and terminals for minerals, oil and chemical products, oil, gas and mineral pipelines; extraction fossil fuels (oil, shale and coal); or for those undertakings or operations which are identified as having a significant environmental impact according to the criteria of the competent environmental agency.

On August 29, 2001, IBAMA Normative Ruling No. 10, which established the Federal Technical Registry of Potentially Polluting Activities or Users of Environmental Resources, was published. Such Normative Ruling establishes that those who are subject to the Environment Control and Inspection Tax - TCFA are required to deliver to IBAMA until March 31 of each year a Yearly Report of the activities developed in the previous year. Noncompliance shall subject the transgressor to a fine in the amount provided for in paragraph 2 of Article 17-C of Law No. 6,938/91.

Considering the need to establish safe strategies for the prevention and management of environmental impacts resulting from establishments, activities and facilities of oil and its by-products in Brazil, CONAMA Resolution No. 265/00 set forth that companies involved in these activities must present work programs and timetables for independent environmental audits in their facilities.

On July 05, 2002, CONAMA Resolution No. 306/02 was enacted establishing the minimum requirements and term of reference for the preparation of the periodical independent environmental audits to evaluate the management and environmental control systems in organized ports and port facilities, platforms and their support facilities and refineries. According to such rule, the independent environmental audits must be carried out by third companies and its report as well as the action plan prepared in connection thereto shall be presented to the environmental agency every two years and shall be filed at the corresponding environmental licensing proceeding of the audited facility.

Downstream

Any company may submit a proposal to ANP to operate or to construct refineries or operate natural gas processing units, as well as to construct installations and use any means of transportation for the oil, its derivatives and natural gas, either for domestic supply or for import and export.

The opening of a distributor in Brazil is a simple procedure which requires a prior authorization and registration by ANP. The Agency issued several specific ordinances regulating and explaining in detail all necessary documentation and information to be provided so as to obtain said authorization.

In order to obtain both the registration and the authorization, the prospective distributor must meet several conditions, among which is the minimum stated capital, and it must have the necessary infrastructure for storing the by-products.

Exportation and importation

In order to receive the authorization to export or import crude oil and its by-products, the exporter or importer must provide ANP with all necessary information and documentation related to the business to be rendered. Such information must be updated by the companies every 18 (eighteen) months, subject to the cancellation of said authorization.

Both the importation and exportation of crude oil, its by-products and condensed gas, according to specific ordinances issued by the ANP which regulate this business, shall be performed in strict compliance with certain objectives and principles set forth by the Petroleum Law, such as protection of the consumer's and the Brazilian Treasury, foreign trade rules, national energy policy, principles of transparency and legality, rules for protection of the economic order and environmental regulation.

Tax aspects

a) General Overview

In addition to government takes, companies engaged in the oil and gas industry must pay all the mandatory Brazilian taxes applied to any other industry.

This section seeks to summarize the most significant tax aspects that may particularly affect oil and gas companies.

b) REPETRO Special Customs Regime

In order to develop the oil and gas industry, the Brazilian Congress enacted Decree No. 3,161 of September 02, 1999 (“Decree No. 3,161/99”), providing for a special Customs regime known as “REPETRO”. This regime is intended to provide E&P companies with access to exploration and production equipment upon a reduced tax burden. It also seeks to offer local suppliers favorable conditions vis-à-vis foreign equipment.

REPETRO is currently regulated by Decree No. 4,543 of December 26, 2002 (“Decree No. 4,543/02”), and by Normative Ruling No. 4 issued by the Brazilian IRS on January 10, 2001 (“IRS Normative Ruling No. 04/01”).

This tax incentive applies to the equipment listed under Annex to IRS Normative Ruling No. 04/01, which currently governs REPETRO regime (“REPETRO Goods”). The list of equipment that may be imported under REPETRO has been amended and updated from time to time. It should be noted, however, that the lawmaker seems to have focused its efforts in listing as much as offshore oil-related equipment, having neglected some of the onshore equipment, as well as the and gas-related equipment. REPETRO also applies to spare parts, tools, equipment and other parts and pieces intended for the operations of the equipment listed in the annex to this Normative Ruling.

Only oil and gas concessionaires, service companies contracted by concessionaires or the latter’s subcontractors, may apply for such benefit. In order to apply for REPETRO, the interested company must be previously registered with the Brazilian IRS.

REPETRO regime benefits imports and exports carried out under: (i) Drawback; (ii) Notional Export; and (iii) Special Temporary Admission.

- *Drawback* consists of the suspension of the import taxes on raw materials, semi-finished products and parts to be use in the production of goods that will be exported under the notional exportation regime. In order to apply

for the Drawback regime, the company must be a trade company as per Decex- Exterior Trade Department - Communicate No. 21 of July 23, 1997 and Decex Communicate Nr. 02 of May 07, 1999.

- *Notional Export* is the sale by the manufacturer or trading companies of goods produced in Brazil to companies domiciled abroad or trading companies, with payment in convertible currency. Although the delivery is made in the Brazilian territory, it is leveled to regular export for fiscal and exchange purposes, that is to say, exempted from federal taxes (Article 8 of the IRS Normative Ruling No. 04/01).
- The Special Temporary Admission has more vast provisions. Under REPETRO Regime, goods imported under the temporary admission regime remain in Brazil with complete suspension of federal taxes levied on importation (Import tax and Federal Excise Tax) for the duration of the contracts entered into to carry out operations. REPETRO applicant must provide the Brazilian IRS with, among other things, the following documents: (i) Request for the Concession of the Regime ("*Requerimento de Concessão do Regime*" or "RCR"); (ii) Term of Responsibility ("*Termo de Responsabilidade*"), through which the applicant undertakes to pay the value corresponding to the taxes suspended, if it fails to comply with REPETRO's conditions; and (iii) instrument of guarantee, if the value of the goods subject to REPETRO are superior to twenty thousand *Reals* (R\$20,000.00).

It is important to highlight that goods subject to finance leasing agreements can not be imported under the REPETRO, per Article 2 of the IRS Normative Ruling No. 04/01. The contracts normally elected by companies are: (i) operational lease agreement; (ii) rent agreement; and (iii) charter agreement.

REPETRO Goods must be depreciable goods, never consumable and, according to Article 13 of the IRS Normative Ruling No. 04/01, they must comply with the following conditions: (i) belonging to a legal entity with headquarters abroad; (ii) having been imported without exchange cover; (iii) proceeding from abroad or be in Brazil under the Drawback or the Notional Export conditions (as defined below). In case of vessels, the granting of REPETRO will also be subject to the Navy authorization to operate in Brazilian waters.

REPETRO Goods may be kept in Brazil for the same duration of the contract to which it is subject (i.e., concession agreement, services agreement executed with

the concessionaire or its subcontract). In case of (i) operational lease agreement; (ii) rent agreement; (iii) free lease agreement; the term of REPETRO can not be greater than that of such agreements. In case of vessels subject to the temporary admission regime of REPETRO, which depend on Navy authorization to remain in the Brazilian territorial sea, the period of validity of the regime may not exceed the term foreseen in the Navy authorization.

In order to extend the validity term of REPETRO, its beneficiary must present to the Brazilian IRS a request for extension of such regime (“*Requerimento de Prorrogação do Regime*” or “RPR”), previously communicated to the unit of the Brazilian IRS that first granted the regime the establishments where such shared use of the REPETRO Good will take place, for purposes of amendment of the Import License, prior to the termination of the regime being extended.

The REPETRO Good must be linked to a specific establishment of the concessionaire company or of the company authorized to perform oil and gas activities and may be transferred to another one of its establishments previously registered with the Brazilian IRS. However, the beneficiary of REPETRO must previously communicate to the unit of the Brazilian IRS that first granted the regime the establishments where such shared use of the REPETRO goods will take place, for purposes of amendment of the Import License (“*Declaração de Importação*” or “DI”), as per Article 23 of the IRS Normative Ruling No. 04/01.

The REPETRO goods subject to REPETRO based on a service contract with a concessionaire or company authorized to perform oil and gas activities may be used only by the service company to perform services to another concessionaire or authorized company if: (i) the term of the contract signed with the other concessionaire or authorized company is inferior to the term of the REPETRO regime; (ii) the contract that first supported the granting of REPETRO did not establish an exclusivity clause for the use of such goods; (iii) this shared use of the REPETRO goods is previously communicated to the unit of the Brazilian IRS that first granted the regime along with the required documents for purposes of amendment of the DI (Articles 24 and 25 of the IRS Normative Ruling No. 04/01).

The temporary admission regime will be extinguished and the related Term of Responsibility will be cancelled, in accordance with article 26 of the IRS Normative Ruling No. 04/01, if the beneficiary adopts of one of the following measures, within the stated term for the permanence of the REPETRO goods in

the Brazil: (i) reexport; (ii) definitive exit of the Brazil, in the case of good manufactured in Brazil and subject to Notional Export; (iii) destruction, at the beneficiary's expense; (iv) delivery to the National Treasury, free of any expenses, if the Customs authority agrees to receive it; (v) transference to another special or atypical customs regimen; (vi) forwarding for consumption; (vii) substitution of the beneficiary, according to the provisions of Article 28 and 35, §4º of the IRS Normative Ruling No. 04/01.

The Decree No. 5.138 of January 12, 2004 amended the Decree No. 4,543/02 to extend the REPETRO regime until December 31, 2020.

As of May 1, 2004, the importation of assets will also be subject to the federal welfare PIS and COFINS contributions, at the rates of 1.65% and 7.6%, respectively. Please note that the PIS and COFINS legislation establishes that the rules on special customs regimes, such as the REPETRO – providing for Import Duty and Excise Tax suspension shall also apply to PIS and COFINS.

c) Bonded Warehouse Special Customs Regime

Normative Ruling No. 513, issued by the Federal Revenue Department, on February 17, 2005, provides for the possibility of operating the bonded warehouse regime, applicable to the construction and conversion of offshore oil rigs and offshore rig modules, on rigs under construction or conversion, on quaysides, or in any other industrial seashore facilities, intended for the construction of maritime structures, oil rigs and rig modules.

The bonded warehouse regime may be applied to materials, parts, pieces, and components used on offshore rigs under construction and conversion in Brazil, intended for exploration and production of oil and gas, and contracted by foreign companies. In order to qualify for the regime, a Brazilian company must have already been contracted by a foreign company for the construction or conversion of an oil rig or module. This regime provides for the suspension of the federal taxes levied on imports – i.e., Import Duty, Federal Excise Tax (IPI) and Federal Social Contributions (PIS and COFINS). It also applies to the taxes levied on the local acquisition of goods – i.e., Federal Excise Tax (IPI) and Federal Social Contributions (PIS and COFINS) – provided such goods are incorporated into the oil rig or module to be exported. As a matter of fact, the “suspension” of federal taxes means that no taxes will be due, provided the oil rigs or rig modules under construction or conversion are intended for exportation.

Let us highlight that the bonded warehouse regime will also apply to oil rigs and rig modules that are notionally exported from Brazil, *i.e.*, whenever these assets are acquired by a foreign buyer, without leaving the Brazilian territory, and are delivered, by order of such foreign buyer, to the legal entity contracted to carry out their construction or conversion, the payment shall be made in convertible currency.

On the other hand, if a rig or module is not exported – notionally or physically – the taxes suspended shall be effectively paid with delayed fine and interest. In addition, if a given asset has not been incorporated into the rig or module being exported, the taxes suspended corresponding to such asset shall be also due.

d) The State Value-added Tax (“ICMS”) and the State of Rio de Janeiro.

ICMS is a value-added tax on sales and services, payable upon importation of a product into Brazil, or upon its sale or transfer within Brazil, or as to certain communications and intra and interstate transportation services, at the time when the service is provided. ICMS rates and tax benefits depend on the type of transaction, and vary from state to state, but are usually levied at a rate of seventeen or eighteen percent (17-18%). In the State of Rio de Janeiro, the current ICMS applies at a 19% rate (18% plus an additional 1% intended for the state fund for struggle against poverty, created by Law No. 4056/02).

d.1) “Valentim Law”

Agreement No. 58 of October 28, 1999 (“Agreement No. 58/99”) authorized the Brazilian States to grant reduction in or exemption from the ICMS levied on assets imported into Brazil under the temporary admission regime. In this regard, when federal customs duties are suspended, such as in the REPETRO regime, the States may exempt the importation from the ICMS.

In this sense, the State of Rio de Janeiro, which accounts for the largest portion of the Brazilian oil and gas production, ratified the provisions set forth in Agreement No. 58/99, by enacting Decree No. 25,809 of December 8, 1999 (“Decree No. 25,809/99”) and regulated them through Decree No. 26,139 on April 4, 2000 (“Decree No. 26,139/00”).

However on June 12, 2002, Law 3,851 (the “Valentim Law”, as nicknamed after its primary sponsor) abolished the ICMS exemption on the import of equipment intended for the oil and gas industry and imposed, as from July 30, 2003, an ICMS tax assessment of nineteen percent (19%) on such equipments. Valentim Law expressly establishes that the provisions of Decree No. 26,139/00 shall not apply to the import of oil and gas equipment.

The assets subject to the provisions of the Valentim Law comprise all types of platforms and floating systems, including those intended for the production of processed or semi-processed oil, plus the modular units to be installed in these platforms, as well as their subsea anchoring accessories, and for activities covering the interconnection and completion of subsea wells, including all the equipment interconnected during the exploration and drilling stages.

The Valentim Law expressly excluded from the ICMS levy all equipment used in the exploratory phase, imported to carry out temporary services in Brazil for a period of less than twenty-four (24) months, and all equipment used as parts and pieces in the construction and assembly, in Brazil, of oil production platforms and floating systems, plus their modular units.

Notwithstanding the above, on February 17, 2004, the government of the State of Rio de Janeiro published Decree No. 34,811 (“Decree No. 34,811/04”), which provides for a partial tax relief, excluding from the ICMS levy:

- (i) *accessories, parts and pieces used in the construction or assembly of floating systems, of production or drilling platforms to be processed, built or assembled in units located in Rio de Janeiro (Paragraph First of Article 2 of Decree No. 34,811/04);*
- (ii) *production or drilling platforms, which are in transit for repairs or maintenance in industrial units in the State of Rio de Janeiro, or in transit for drilling in another State (Paragraph First of Article 2 of Decree No. 34,811/04);*
- (iii) *all equipment imported for use in the exploration phase in the State of Rio de Janeiro, regardless of the length of time it would stay in Brazil (i.e., such stay would no longer be limited to the twenty-four (24) months established in the Valentim Law), per Article 4 of Decree No. 34,811/04;*
- (iv) *parts, pipes, connections, pieces intended for the operations of the aforementioned equipment (Sole Paragraph of Article 4 of Decree No. 34,811/04); and*

- (v) *equipment used in the exploration and production of oil and gas in the State of Rio de Janeiro, which were imported under a temporary admission regime before June 30, 2003 (Article 5 of Decree No. 34,811/04).*

In addition to that, Article 3 of Decree No. 34,811/04 releases from the ICMS tax assessment all equipment used in both the exploration and production phases, which remains in Brazil for a period equal or superior to twenty-four (24) months.

It is important to notice that a lawsuit challenging the constitutional basis of Valentim Law (ADI No. 3171) was filed by the Union Attorney-General at the request of the Brazilian Institute of Oil & Gas (“IBP”) and is still in progress. The plaintiff claims that Valentim Law is contrary to Agreement No. 58/99, ratified locally by Decree No. 25,809/99 and nationally by Declaratory Act No. 02/99, therefore revoking the benefit established in Agreement No. 58/99 without the signature of another Agreement.

d.2) “Noel Law”

On July 30, 2003 the Governor of the State of Rio de Janeiro enacted Law No. 4,117 (“Noel Law”, as nicknamed after its primary sponsor), provides for some changes in Law No. 2,657/96, which governs ICMS in the State of Rio de Janeiro, setting forth an 18%, ICMS levy on the extraction of oil carried out in the State of Rio de Janeiro.

As explained previously, ICMS is usually levied on the circulation of goods. Rio de Janeiro State, however, argues that, after the oil or gas is extracted, it passes through the production measurement points, its property is transferred from the Union to the concessionaire. So, this would characterize a circulation of goods, being as such subject to the payment of ICMS.

The National Transportation Confederation (“NTC”) is challenging the constitutional basis of the Noel Law, through ADI No. 2,080. NTC argues that the ICMS tax-triggering event does occur at the moment of the extraction of the crude oil from the subsoil, since there is no circulation of goods.

On July 30, 2003, Decree No. 33,484 (“Decree No. 33,484/03”) granted a deferment on the payment of the ICMS levied on oil extraction, when the crude oil extracted is intended for exportation, which has its point of shipment

anywhere in the territory of the State of Rio de Janeiro. Decree No. 33,484/03 provides that the payment of ICMS, in this case, shall be made when the crude oil is exported through offset against equivalent tax credit.

Decree No. 34,761 of February 3, 2004 (“Decree No.34,761/04”) regulated the provisions of Noel Law. Please note, however, that the government heard the industry’s plea and suspended Decree No.34,761/04 upon the enactment of Decree No. 34,783 of February 4, 2004. Considering that Noel Law needs to be regulated in order to be enforceable and the companies sustain that until Decree No. 34,761 is reestablished – or new regulations are enacted – the ICMS taxation created by Law No. 4,117/03 will not apply.

d.3) Special tax benefits created by the State of Rio de Janeiro.

Some Brazilian States provide for special tax benefits concerning the levy of the State Value-added Tax (ICMS) to encourage the development of naval and oil and gas related activities in their territories.

The State of Rio de Janeiro, currently responsible for most of the oil produced in the country, even though it has increased the sector’s tax burden by enacting the Valentim and Noel Laws, has recently provided for a tax relief on transactions with several equipment intended for naval and oil and gas industries, to encourage the State manufacturers.

In this regard, on March 28, 2005, the Governor of the State of Rio de Janeiro issued (i) Decree No. 37,188, releasing from the ICMS payment interstate transactions with several oil and gas related equipment carried out by manufacturers domiciled in Rio de Janeiro, and (ii) Decree No. 37,196, which benefits the intrastate acquisition of inputs and modules to be used in the construction of oil & gas floating systems.

Since the tax benefits were granted by means of State Decrees, without the prior approval from other States by means of an Agreement (“Convênio”), there is a risk that other States may challenge the benefits at the Brazilian Supreme Court. This is because the Brazilian Federal Constitution of 1988 provides that a complementary law (i.e., a law that requires a higher quorum to be approved) shall establish how ICMS benefits will be granted. However, since, to date, a new complementary law has not been enacted to rule this matter, Complementary Law No. 24/75 (LC 24/75), enacted before the Constitution, still regulates the

granting of State tax benefits. To this end, LC 24/75 provides that any tax benefit granted by a given State – such as exemption, reduction or presumed credit – is subject to the approval from the other States by the enactment of an Agreement. This requirement aims at struggling against the “tax wars” among the States, avoiding unilateral tax benefits.

Decree No. 37,188/05 provides that manufacturers established in the State of Rio de Janeiro that carry out interstate sale/transfer of certain oil and gas related equipment mentioned in the annex to the Decree (which include umbilical connectors, wet Christmas trees, and manifolds, among other equipment and accessories) are granted a presumed tax credit at an amount equivalent to the tax debt in such transactions. In other words, taxpayers are released from the ICMS payment to the State of Rio de Janeiro in such transactions.

Manufacturers benefited by the Decree must carry out all import transactions relating to their establishments in Rio de Janeiro by these State ports and airports. The benefit is granted for a 10-year-term and is subject to the fulfillment of certain requirements – such as not having any pending debts with the state tax authorities.

Decree No. 37,188/05, in turn, provides for a deferral of the ICMS tax levied on intrastate acquisitions of inputs and modules to be used in the construction of oil and gas floating systems – the tax will only be due when the system is delivered to the end buyer. Notwithstanding the above, in this case the deferral is a true tax release, since the Decree also states that upon the delivery of the oil rig by the manufacturer, the tax debt shall be offset with a credit that would be due if the tax had not been deferred.

The benefit is granted for the construction, conversion, and assembly of the hull, deck and modules to be integrated into the floating oil rigs, in the State of Rio de Janeiro territory. In order to benefit from the tax release, the agreements for the construction, conversion, etc. should be executed starting on the date the Decree was enacted (i.e., March 28, 2005).

The Decree also provides that, once the input integration into the oil rig is proven, the delivery of this oil rig shall be tax exempted, in accordance with the terms of ICMS Agreement No. 33/77.

e) ICMS in the State of São Paulo

Decree No. 48,115 of September 26, 2003 amended the ICMS Regulations (Decree No. 45,490, of November 30, 2000) creating in the State of São Paulo an ICMS exemption applicable to the goods submitted to the REPETRO in order to incentive oil and gas companies to invest in that State.

In this sense, Decree No. 48,115/2003 provides that the ICMS exemption shall apply to (i) the importation and local acquisition of inputs for the manufacture of certain oil and gas equipment/ systems, which will be further transferred to a foreign resident (even if such equipment/systems do not leave the Brazilian territory, i.e., if they are notionally exported); (ii) the importation of goods to be used in the exploration and production of oil and gas under the temporary admission regime; and (iii) the domestic acquisition of goods by foreign residents with payment in convertible currency (notional export).

The application of the tax benefit requires compliance with certain requisites established in the Decree, such as:

- (i) If the good is manufactured in Brazil, and is subject to an interstate operation or operation within the State of São Paulo, it must: (a) be acquired directly from the manufacturer by a person domiciled abroad, upon payment in convertible currency and delivery in the Brazilian territory under Customs control; (b) remain in the Brazilian territory under the temporary admission regime, according to the provisions of the federal legislation;
- (ii) If the good proceeds from abroad, it must: (a) be imported under the Drawback (suspension of Federal taxes) and remain under REPETRO regime; (b) have no similar goods produced in Brazil, as certified by competent federal agency or entity representing manufacturers of the subject good; (c) the landing and the customs clearance are effected in the State of São Paulo;
- (iii) The goods must be released from the levy of federal taxes, due to exemption, suspension or zero rate;
- (iv) The applicant must provide the competent tax authorities with a term of responsibility, as well as an instrument of guarantee (i.e., deposit in cash, pledge using government bond or Customs insurance in favor of the Union); and

- (v) The applicant must give the tax authorities access to its accounting and inventory control, allowing the government to control the application of REPETRO, as well as the use of REPETRO Goods, at any time, through direct access to its computerized system.

f) Contribution for Intervention in the Economic Domain (“CIDE”) on Fuels

Law No. 10,336 of December 20, 2001 (“Law No. 10,336/01”), created CIDE which is the contribution levied on the import and sale of certain types of fuel (*i.e.*, gasoline and its chains, diesel and its chains, aviation kerosene, and other types of kerosene, oil fuel, liquefied petroleum gas – including that from natural gas and from naphtha – and ethyl alcohol fuel per its Article 3), at the rates fixed at its Article 5.

However, Decree No. 5,060 of April 30, 2004 (“Decree No. 5,060/04”) reduced the CIDE rates: levied on gasoline (and its chains) to R\$280,00/m³ (two hundred and eighty *Reals* per cubic meter) and levied on diesel (and its chains) to R\$70,00/m³ (seventy *Reals* per cubic meter). Decree No. 5,060/04 has also reduced the rates to zero for the other products listed under the preceding paragraph.

CIDE taxpayers are the producers, formulators or importers of liquid fuels. Note that the CIDE amounts paid may be deducted from PIS and COFINS levied on the sales of liquid fuels in Brazil.

Finally, it is important to highlight that, according to Article 10 of Law No. 10,336/01, CIDE does not apply to sales of goods to trading companies, with the sole purpose of exporting goods.

[Revised as of September 2006]

International Trade Regulation

International trade relations are regulated by a set of rules and agreements negotiated in bilateral, regional and/or multilateral forums, aimed at promoting the transparency of such relations and the continuous liberalization of international trade, within the context of the global economy.

In this context, it is worthy to note the activities of the World Trade Organization (WTO), which was created in 1994 and is made up of more than 147 members, including Brazil. Moreover, trade relations in Brazil are also heavily influenced by the rules of MERCOSUR, which includes Argentina, Uruguay and Paraguay as founding members, and Bolivia, Chile, Peru, Colombia, Ecuador and Venezuela as associate members.

The international trade system, established under the WTO and other international agreements, has a direct impact on virtually all trade in goods, the international provision of services, including distribution, telecommunications, financial and professional services, and the protection of intellectual property rights. These rules provide businesses with access to new markets, improved competitive conditions in existing ones, and a framework in which to plan investment and within which to rely upon enforcement of international obligations.

As a founding member of the WTO, the Brazilian Government is responsible for ensuring compliance with the WTO Agreements on the national level, for safeguarding the Brazilian industry against unfair trade practices implemented abroad, and for affording commercial viability of foreign companies. The WTO Agreements were incorporated into national law in December 1994, following the ratification of Presidential Decree No. 1.355 of December 30, 1994.

In addition, as a member of the Asunción Treaty, which established the Southern Common Market or MERCOSUR in 1991, Brazil is part of a free trade zone aimed at eliminating all tariff and nontariff barriers for virtually all trade among the group's founding members, thus guaranteeing a free transit of products, services and factors of production between and among the member states. Moreover, the Asunción Treaty established a customs union with a Common Foreign Tariff (TEC) ranging from 0 to 20% for 85% of products, applicable to imports from nonmember states. It also put in place a common set of rules of origin and the gradual coordination of macroeconomic policies among member states.

Additional protocols to the Asunción Treaty, such as the Protocol of Brasilia, the Protocol of Ouro Preto, the Protocol of Fortaleza and the Protocol of Olivos, provide MERCOSUR with, *inter alia*:

- (i) a dispute settlement system based on three alternatives: negotiation, conciliation and arbitral procedures, with the possibility to an ad hoc arbitration tribunal and/or a permanent tribunal of review,
- (ii) the status of a legal person which allows MERCOSUR to respond as a single entity with rights and obligations and to enter into international negotiations as a bloc,
- (iii) an institutional structure, in which decisions are taken under a consensual and intergovernmental basis and then, incorporated by each member state in its own legislation; and
- (iv) a common set of rules for a competition regime under a regional approach.

Brazil is also a founding member the Latin American Integration Association (ALADI) created in 1980 with the view of establishing an economic preference zone, providing favorable conditions to the growth of bilateral enterprises, as a prelude to the institution of multilateral relationships in Latin America. Under the auspices of ALADI, Brazil signed several trade agreements with other Latin American countries, granting and receiving a large number of tariff preferences. Aside from the free trade zone with its Mercosur partners, Brazilian imports and exports had benefited from significant preferences contracted with Mexico, Bolivia, Cuba, Chile, Peru, Colombia, Venezuela and Ecuador, which had provided Brazil with a privileged position among the best countries as the region to invest in the import-export business.

Over the past few years, Mercosur had been involved in several diplomatic initiatives towards the signature of relevant international trade agreements, such as the negotiations with the European Union, India and South Africa, besides the hemispherical efforts in order to create a free trade zone in the Americas.

An Overview of the Brazilian Regime for Trade Remedies

Other than import restraints, a number of policies of firms or governments are designed to influence international trade. In particular, both governments and

enterprises may wish to promote exports through the use of discriminatory pricing or subsidies. For decades, many versions of these practices have been considered by the international system and many national systems to be “unfair”. To such practices, the international rules have permitted certain responses from the importing nations, such as antidumping duties or countervailing duties.

To comply with its obligations under the WTO, Brazil had adopted supplementary regulations in the fields of trade remedies, including subsidies, antidumping and safeguards. Law No. 9.019/95 provides for the application of antidumping duties and countervailing measures, while Decrees Nos. 1.602/95, 1.751/95, 1.488/95 discipline the administrative proceedings carried out to determine and eliminate the practices of dumping, subsidies and safeguards, respectively.

In brief, the administrative procedure for the investigation of alleged dumping or subsidy can be divided into three phases. The first entails scrutiny of the petition filed by the petitioner(s) representing a domestic industry. This petition should include, inter alia, positive information to demonstrate the practice of dumping/subsidy, the harm to the domestic industry and the causal link between the dumping/subsidy measure and the injury to the same. The Brazilian authorities (SECEX/DECOM) will examine the petition, and they may ask for additional information during the second phase of the procedure, which will be concluded after a final hearing to be attended by the petitioner and interested parties. At this hearing, a technical note will be circulated, summarizing the main data which will be considered by SECEX/DECOM when evaluating the case.

The last stage encompasses the submission of the final opinion drafted by SECEX/DECOM for the review of the Trade Protection Technical Group (GTDC), a task force created under the auspices of the Brazilian Chamber of Foreign Commerce (CAMEX). CAMEX, which is in charge of formulating policies and coordinating activities related to foreign trade, will then issue a final decision as to whether or not impose a provisional or definitive antidumping duty or countervailing measure.

Trade remedies are efficient tools which may be used by the private sector in Brazil as a competitive advantage to hinder the increase in imports which jeopardizes its market share in the national market. Two of the **benefits** of trade remedies are guaranteeing market presence at a national level and protecting investments related to the entry into this market.

Given the frequent recourse to the above-mentioned remedies by WTO members, such mechanisms have actually been applied as nontariff barriers against imports. Therefore, participating and intervening in the investigation of trade remedies undertaken abroad is of great importance to Brazilian exporters. Likewise, foreign companies exporting to Brazil must be aware of possible investigations initiated at a national level which may affect their commercial interests.

International Trade Law in Brazilian Courts

Presidential Decree No. 1.355 of December 30, 1994 incorporated the WTO Agreements into national law, thereby conferring jurisdiction to domestic courts to overview claims of violations to such rules. The WTO offers importers and exporters a set of useful tools to open markets that would otherwise remain closed. To take advantage of WTO opportunities, a business must learn how to use of the rules, and understand and incorporate them into its strategies, and monitor the country's compliance with its obligations under the WTO.

In case of any violation of WTO agreements, a mechanism of dispute settlement may be set up as an alternative to guarantee international compliance to such set of rules and the adoption of practices compatible with the negotiated agreements.

Also under MERCOSUR's framework, the ad hoc arbitration tribunal and the permanent tribunal of review were designed to resolve conflicts between member states and individuals/entities domiciled therein. Just as it occurs in the WTO, the referred courts are intended to maintain the objectives expressed in MERCOSUR agreements which are sustained by the general principles of nondiscrimination, trade liberalization and regional integration.

When should a business use domestic courts in Brazil to enforce international trade rules? The following are some situations in which a government may violate its international undertakings, and a where remedy may be available:

1. Internal laws and regulations are applied in such a manner to protect domestic production vis-à-vis imports;
2. Government discriminates against imported or exported products, or services and service suppliers based on the country of origin, i.e., goods or services from distinct origins which are treated differently;

3. Antidumping, countervailing or a safeguard investigation are conducted by Brazilian authorities in a manner that is not consistent with international agreements signed by Brazil, to the detriment of imports;
4. Environmental protection rules, sanitary measures or technical requirements are applied so as to block imports;
5. Import licensing regime or other acts undertaken by Brazilian customs authorities are inconsistent with WTO or MERCOSUR rules;
6. Government imposes export restrictions with respect to joint ventures which have foreign investment.

Private companies are increasingly presenting claims before domestic courts questioning WTO or MERCOSUR-inconsistent measures, especially in the fields of tax regulation, rules of origin and environmental law.

[Revised as of September 2006]

Corporate Criminal Law

Some of the main issues related to corporate criminal law in Brazil involve:

- crimes against the National Financial System;
- crimes against the economic order;
- unfair competition crimes;
- antitrust crimes;
- tax evasion crimes;
- copyright crimes;
- industrial property crimes;
- crimes against consumers;
- environmental crimes;
- money laundering crimes;
- corruption crimes;
- crimes against the Social Security;
- press act crimes; and
- crimes against honor.

Brazilian System of Evidence

The criminal procedure and the evidentiary system in Brazil are governed by principles and rights provided in the Brazilian Federal Constitution (“Federal Constitution”).

The Federal Constitution, in its Article 5, sets forth that no individual will be deprived of his/her own freedom or assets without the due process of law, further securing the right to adversary proceeding and legal defense. The due process of law, therefore, presupposes equal procedural defense opportunities - the adversary proceeding - and technical defense and self-defense - the guarantee of full defense.

The due process of law also provides for the possibility of appealing to a superior/higher court which may reverse or confirm the judgment rendered as set forth in the Federal Constitution (Article 5, item LV, and Article 93, item III - “access to the higher courts”).

It is also important to note that the Federal Constitution assures that proceedings of evidence obtained by illicit means will be inadmissible. Illicit evidence is prohibited by the Federal Constitution because evidence must be provided by law *nulla coatio sine lege* and by legal means (Federal Constitution, Art. 5, item LVI).

Accordingly, we are highlighting the principle of presumption of innocence, i.e., “no one will be deemed guilty until the criminal sentence becomes final and not subject to appeal”. Thus, every defendant is presumed innocent until the reading of the final condemnation sentence (Federal Constitution, Art. 5, item LVII). Negligence should be legally and judicially proven and evidence should fully regard the due process of law.

In the Brazilian Criminal Procedural System, the one who makes the allegations has the burden of proof (Criminal Procedure Code, Art. 156). However, the defendant has no obligation to prove his innocence because it is presumed by law. During the course of the criminal action, the prosecution is in charge of proving all the allegations contained in the accusation complaint (denunciation).

At last, the Brazilian Criminal System granted the defendant the right to remain silent, which cannot be interpreted against him/her. This is the constitutional guarantee against self-incrimination (Federal Constitution, Art. 5, item LXIII) and the right not to produce evidence against the defendant. Thus, the defendant cannot be prosecuted for lying or omitting facts in his/her own defense or be prosecuted for perjury.

In case of doubt, the defendant should always be acquitted because of another constitutional guarantee, i.e., *in dubio pro reo*.

In addition to the guarantees mentioned above, the Federal Constitution also establishes, among others, the following:

- no one will be submitted to torture nor cruel or unusual punishment,
- inviolability of intimacy, private life, honor, home, mail, telegraphic communication, data and telephone communication and personal image,
- there will be no court of exception,

- there is no crime without a previous law that defines it nor penalty without a previous legal sanction,
- the criminal law will not retroact unless for the benefit of the defendant,
- no penalty will go beyond the person of the defendant,
- it will be guaranteed penalty individualization,
- no one will be prosecuted nor sentenced if not by the competent authority, and
- publicity of the procedural acts.

Therefore, evidence which respects all the guarantees set forth, is the backbone of the criminal procedure, thus identifying the effects of the crime, its results and reasons. There is no crime without a result and criminal conviction for simple presumption or formal evidence is not admissible.

Summary of the Legal Procedures

Following is a summary of the criminal law procedures in Brazil¹⁷.

¹⁷ The following terms are defined thus:

Criminal lawsuit [Ação Penal]: a formal proceeding instituted against the defendant and commenced at the Criminal Court;

Criminal Judge [Juiz Criminal]: the judge responsible for the Lower Criminal Court;

Formal accusation or "Denunciation" [denúncia]: the charge pressed against one or more persons by the Public Prosecutor at the Criminal Court; denunciation;

Indictment [indiciamento]: the formal act by which the Police Chief identifies the presumed suspect of the crime;

Criminal Prosecutor [promotor criminal]: the public prosecutor (district attorney) who works at the Lower Criminal Court and is responsible for overseeing the investigations and filing a formal accusation or requesting the close of the police inquiry;

Close of the investigation [arquivamento]: the act by which the Criminal Prosecutor requests the Judge to close the case when there is no crime or suspect;

Police inquiry [inquérito policial]: a formal proceeding in course at the Police Station and headed by the Chief of Police, which aims to gather evidence to support the formal accusation;

Police precinct clerk [escrivão de polícia]: the assistant to the Chief of Police who will launch the police inquiry;

Chief of Police [delegado]: the precinct chief who heads the police inquiry;

Criminal Expert [perito]: the technical professional who assists in the investigations whenever requested by the Chief of Police and Criminal Prosecutor and who usually works at the Criminal Institute [Instituto de Criminalística];

Detective/Inspector [investigador]: the assistant of the Chief of Police, who will conduct the necessary investigations.

According to Brazilian law, the Criminal Prosecutor can denounce the offender when there are elements indicating that one or more crimes have been committed and such actions may be related, in principle, to the offender's conduct. Usually, the Criminal Prosecutor grounds the formal accusation on the outcome of the investigations conducted during the police inquiry.

Additionally, a police inquiry may be launched at the request of the Prosecutor or Judge, as well as upon the pressing of a charge or preliminary investigation.

Once it starts, the chief of police in charge will determine what kind of investigation should be conducted and will make other provisions, such as the conduct of hearings.

In spite of the difficulty in accurately estimating, a police investigation is expected to last from at six months to a couple of years, sometimes getting close to the term set forth in the statute of limitations.

According to applicable laws, every 30 days or so, the police inquiry has to be sent to the Criminal Court to request additional time for further investigation, until the Chief of Police writes a final report. It takes a few days for the proceedings to be submitted to Court, after which, the Criminal Prosecutor agreeing with the time requested, the proceedings return to the police station.

The police inquiry is prepared in writing and includes a deposition (but excludes cross-examination).

In fact, the Chief of Police is supposed to gather all evidence that will enable the Criminal Prosecutor to choose one of the following alternatives:

1. File a formal accusation if there is evidence of crime, in which case the Criminal Prosecutor will ask the judge to initiate a criminal lawsuit against the individuals responsible for the crime;
2. Close the investigation if there is no crime, there is lack of evidence, or there is no one responsible for the "crime", in which case the Criminal Prosecutor asks the Judge to dismiss the case; or
3. Ask the police to make further investigations.

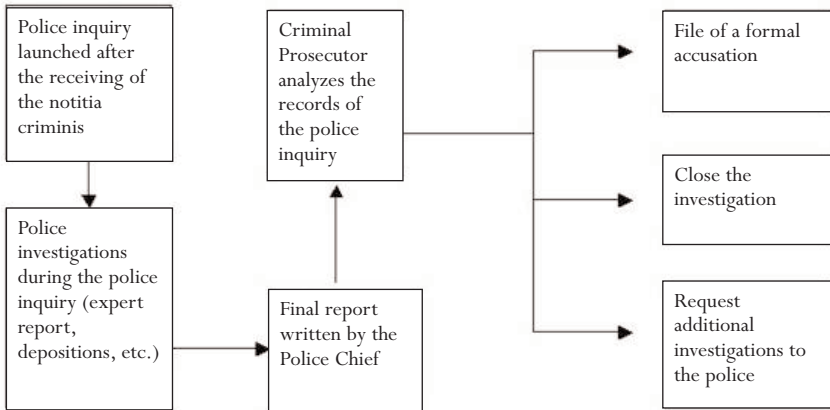
During the police investigation, when the Chief of Police decides he has enough elements to identify a suspect, he/she will be indicted (indictment).

Moreover, the Chief of Police can request the production of a criminal expert report if there is any sign that a crime has been committed.

Notwithstanding the fact that the request for production of a criminal expert report is made by the Chief of Police or Criminal Prosecutor, the Criminal Institute [Instituto de Criminalística] is deemed an independent public body.

A criminal lawsuit starts only when the Criminal Judge receives a formal accusation or “denunciation” (technical term). After receiving the document presented by the Criminal Prosecutor whereby he/she states that one or more crimes were committed and there are sufficient elements to identify who committed the crime, the Judge will set a date for interrogation (the hearing of the defendants). The formal accusation/denunciation presented by the Criminal Prosecutor lists the witnesses he wants the Judge to hear.

Following is a chart summarizing the flow of the Police Inquiry until the start or discontinuance of a Criminal Lawsuit:



Criminal liability of corporate managers

On the one hand, criminal liability results from the commission of a crime imputable to a person due to willful misconduct or negligence. This fact must be set forth in the criminal legislation, considering that there is no punishment or crime without a law defining it (*nulla poena nullum crime sine lege*).

On the other hand, the criminal offense does not exclusively lead to the State's intention to punish. It also leads to the individual's intention to seek indemnification for the damage to the victim. Civil liability, therefore, can also arise from an offense, which brings damage, pecuniary or not, to the victim.

Thus, the system adopted in Brazil is that of the Separation or the Independence of Instances, in which it recognizes the independence of the civil and the criminal courts (except if the criminal decision regarding the authorship and the existence of the offense prevails over the civil decision). Therefore, the Judge of any civil lawsuit is allowed to suspend the course of the respective proceedings until a judgment has been handed down.

This means that a final criminal decision (not subject to any other appeal) is valid at the civil courts, where the party may directly file for a collection lawsuit without the need to commence a new discovery phase (with hearings, experts etc).

Different from what occurs in the civil sphere, Brazilian Criminal Law does not accept strict liability, once all pieces of evidence of a crime have been submitted and, necessarily, result from willful misconduct or negligence. The chain of causation has to be present as a condition to establish criminal liability. Brazilian Criminal Law, therefore, operates under the name of culpability or subjective responsibility.

Criminal liability is personal. It has always been personal, which means that only the person who is directly related to the crime may be held liable for the illicit act. Such principle, under Article 29 of the Criminal Code, sets forth that the corporate entity (with the exception of environment-related offenses) is not to be held criminally liable for its actions. Nevertheless, all of its employees, managers, officers and legal representatives who have committed any criminal act will be held liable for the offense, even if acting on behalf of the company. The purpose of criminal liability is to punish the company's manager for his/her acts previously identified as crimes under the provisions of criminal laws in force.

Citing this explanation, we may conclude that only the individual who participated in the offense can be criminally sued. Officers, managers, legal representatives or employees of the company who did not take part in the offense, whether due to lack of authority or interference in the matter, or because they were not in the company upon occurrence thereof, cannot be held criminally liable.

Finally, it is important to mention that the Public Prosecutor, upon preparing the charge (technically called “denunciation”) must describe the facts as required by law, informing the conduct of each defendant, further clarifying how each defendant has specifically participated or in the criminal act.

However, our case laws and jurisprudence carry different opinions on the validity of the generic denunciation which does not specify and separate the defendant’s conduct in corporate crimes.

However, based on our understanding, even in corporate crimes, the description of the participation of each defendant in the criminal act is essential to denunciation because of the imposition of the constitutional guarantees of the criminal proceedings. In crimes committed “through a corporate entity”, the criminal liability of the ones who have taken part in the offense is subject to varying degrees of culpability.

We also agree with the understanding that the acceptance of the generic denunciation confirms criminal strict liability, what is inadmissible in view of the specific constitutional guarantee of presumption of innocence.

In summary:

1. criminal liability is personal;
2. legal entities do not commit crimes and do not have criminal liability, except in crimes against the environment;
3. criminal liability of officers or managers cannot be determined just because they represent corporate entities;
4. criminal liability of the representatives of corporate entities must be verified separately by evidencing their participation in the illicit act, and strict liability cannot be accepted in relation thereto.

Corporate crimes

In the beginning of the 1980s, the first laws concerning corporate crimes, also known worldwide as white-collar crimes, were enforced in Brazil.

The appearance of corporate crimes, distinguished by a more intelligent, organized and sophisticated modus operandi of the culprit, led to the development and adjustment of criminal legislation to effectively respond to this special kind of criminality.

Following is a summary of criminal liability of corporate managers in accordance with the laws in force, mainly under the provisions that pertain to:

- (i) taxes,
- (ii) labor,
- (iii) bankruptcy,
- (iv) the environment,
- (v) consumer needs, and
- (vi) economic laws:

1. Criminal Liability of the managers under tax laws (Brazilian Tax Code and Law No. 8.137/90)

The manager would be held criminally liable for tax evasion and crimes against the economic order provided in Law 8.137/90¹⁸, if the company manager neglects information or provides false information to or deceives tax authorities, provides incorrect or untrue data or neglects operations of any kind in a document or book required under tax laws.

2. Criminal Liability of managers under labor laws

In the criminal sphere, the manager would be held liable if he/she fails to comply, through fraud or violation, with a labor right assured by existing labor laws¹⁹.

¹⁸ It defines the crimes against the tax and economic order and against consumer relationship, and makes other provisions.

¹⁹ Article 203 of the Criminal Code.

3. Criminal Liability of managers under bankruptcy laws (Law No. 11.101/2005)

Law No. 11.101/2005 further provides for criminal liability in the event certain acts are performed upon the company's bankruptcy. In addition, the managers will be held equivalent to the debtor or the bankrupt party for all criminal purposes provided in the said law²⁰.

4. Criminal Liability of managers under environmental laws

The Environmental Code has introduced a new provision which foresees the possibility of holding the company manager liable for the environmental crimes committed.

The manager could be held liable for environmental crimes if he/she contributes to the commission of a criminal act or if, being aware of such illegal conduct of a third party, fails to prevent its performance, as the case may be[5].

5. Criminal Liability of managers under consumer laws (Law No. 8.078/90)

The company manager maybe held liable for the crimes stated in the Consumer Protection Code, if he/she contributes to such crimes or causes, allows or in any other manner approves the supply, offer, display for sale or maintenance in warehouses of products, or rendering of services under the conditions not provided by the Code.

6. Criminal Liability of managers under economic laws (Laws No. 8.884/94 and No. 8.137/90)

Law No. 8.137/90 defines the acts considered as crimes against the economic order, such as abuse of economic power or manipulation of market prices, which may be attributed to the manager.

²⁰ See article 179

²¹ Article 2 of Law 9.605/98.

7. Criminal Liability before the national financial system (Law no. 7492/86)

A financial institution can be defined, in general, as any entity whose main activity is to deal with the investment of financial resources, in national or foreign currency, as well as those that negotiate securities²². The manager or legal representative of a financial institution may be held liable for a crime against the national financial system if he runs the company fraudulently, or if he provides false information to the competent authorities regarding securities or accounting records.

8. Other considerations regarding the liability of managers within the criminal sphere

The Brazilian Criminal Code does not provide for the criminal liability of managers in any special chapter, but typifies certain modes of conduct, i.e., the manager who makes a false statement on the company's economic situation or willfully conceals, fully or partially, facts related to the company or distributes fictitious profits or dividends.

It should be noted that, in connection with the criminal liability of managers, the deprivation of freedom and alternative sanctions are to be applied to the company's legal representatives, once proven that they have contributed to the commission of the crime through negligence, imprudence or malpractice.

Notwithstanding the crimes provided in the Brazilian Criminal Code and the abovementioned laws, the criminal liability of managers is also provided in case of crimes against welfare (Law No. 1.521/51) and intellectual property rights and unfair competition (Law No. 9.279/96).

[Revised as of September 2006]

²² See article 1.

