



Foreign Investment in Brazil

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The last fifteen years

To become a leading emerging market, Brazil has undergone a remarkable transformation from economic isolation to global integration. Milestones in this development include the privatization program started in 1990, extensive import tariff reform from 1991 to 1993, external debt re-negotiation completed in 1994, and the execution of the Asuncion Treaty of March 26, 1991 between Argentina, Brazil, Paraguay and Uruguay, creating Mercosul, the Southern Cone Market. Mercosul came into effect on January 1, 1995 and is arguably the most important trade agreement in the Americas after NAFTA. Control of inflation, however, was perhaps the single most important development contributing to Brazil's recent economic and political stabilization. By containing chronic inflation and promoting fiscal reform, the Brazilian Government inspired domestic and foreign investor confidence and spurred internal consumption and foreign investment levels. Extensive legal reforms consequently followed suit to help Brazil's legal framework keep pace with rapidly changing economic realities, particularly enhanced foreign investment opportunities.

A key legal reform was the 1995 Amendment to the 1988 Federal Constitution, which removed foreign investment restrictions in certain economic sectors, including petroleum, mining, domestic transportation and local gas service activities, by revoking provisions which distinguished between a *Brazilian company* and a *Brazilian company of national capital*. A Brazilian company of national capital was defined to mean a company that was effectively controlled, directly or indirectly and in a permanent manner, by persons physically domiciled or resident in the country or by Brazilian public entities. Effective control was deemed to mean majority voting and management control. Foreign investment restrictions remain in certain areas, however, such as nuclear energy, rural property ownership, border activities, mail and telegraph, domestic aviation and aerospace. In addition, foreigners cannot hold more than 30 percent of Brazilian press and broadcasting companies.

Foreign investors have responded favorably to Brazil's market and legal reforms, establishing domestic market presence through a variety of investment structures. Distribution and sales representation agreements with Brazilian individuals and/or companies may be used as preliminary investment vehicles to survey the Brazilian market and often precede the establishment of a direct local presence. Where market conditions support a local presence and associated investment costs, many foreign investors establish a Brazilian subsidiary. Alternatively, foreign investors may seek to conduct activities through a joint venture with, or acquisition of, all or part of, a knowledgeable, experienced and connected local company to complement their strengths. This paper will review each of these investment alternatives and other key foreign investment considerations.

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Preliminary Investment Vehicles

Cost savings, among other factors, usually motivate the election of distribution and sales representation activities as a means to survey and participate in the Brazilian market without establishing a direct local presence. These vehicles are also used by foreign investors with a direct local presence, such as those with a local subsidiary, for economic and logistical reasons. Opportunities for cost savings presented by these vehicles, however, should be carefully weighed against the loss of direct control over the manner in which the product is introduced and placed in the market and the resulting market penetration, which could, in some circumstances, adversely affect the current and future activities of the foreign investor in Brazil.

In the case of either distribution or sales representation agreements, the foreign investor should structure activities with a view towards establishing and/or increasing its local presence in the future. In short, the foreign investor should be careful not to surrender all rights to offer the object products in Brazil or to do so for an unreasonably long period of time. As an initial step, prior to entering into a distribution or sales representation agreement, the foreign investor should register its trademark with the National Institute of Industrial Property (INPI), to protect its right to use and control the use of its trademark in Brazil. At this stage, the foreign investor should also verify whether the object products are subject to import license requirements, as well as to registration before the relevant authorities. If so, the foreign investor should establish a Brazilian subsidiary in order to register the object products in its own name.

Distribution Activities

Distribution activities in Brazil should be governed by written agreements, which, however, are not subject to specific legislation, except for the distribution of motor vehicles and spare parts, governed by Law 6,729 of November 28, 1979. Nevertheless, distribution agreements are affected by the general provisions of the Brazilian Civil Code relating to contractual obligations, including a provision which states that an agreement without a definite term may only be terminated by one of the parties if, taking into account the nature of the agreement and the period during which the agreement was in force, the other party has had sufficient time to recover the investments made by it in connection with such agreement.

The distribution agreement should specifically define the object product, sales territory and minimum purchase obligations, if any. Other important considerations include: (i) product supply, (ii) distribution support to be



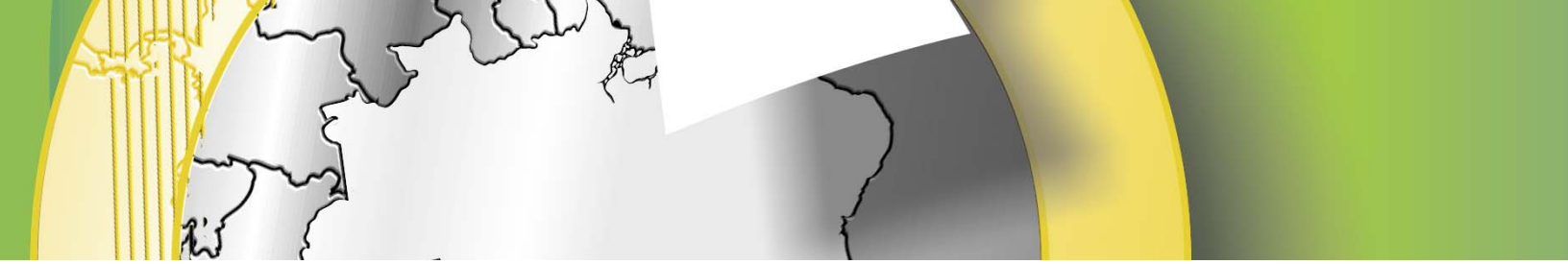
provided by the manufacturer, (iii) exclusive distribution rights specific to the product, distribution points and/or territory, (iv) distribution network and client sales and relationships, including compliance with provisions of the Consumer Code and warranty issues, (v) inventory, (vi) advertising, (vii) trade name and trademark use and (viii) termination. The agreement may provide for dispute resolution by arbitration. Particular care must be taken in drafting exclusivity clauses. The foreign investor should negotiate for the exclusion of exclusivity rights altogether, or to the extent possible, limited rights, to safeguard the supplier's control over current and future distribution activities.

Sales Representation

The activities of independent sales representatives are governed by Law 4,886 of December 9, 1965, as amended by Law 8,420 of May 8, 1992, and by the Brazilian Civil Code. In the exercise of their activities, sales representatives do not acquire products in their own name, but merely act as intermediaries in the sale of products. In exchange, sales representatives are entitled to commissions based on the total value of products sold by the supplier through the sales representative.

The relationship between the sales representative and the supplier is subject to statutory provisions and should also be governed by a written agreement outlining the general terms and conditions of the sales representation, which must be carefully drafted so as not to resemble those characteristic of an employment relationship, such as the performance of activities under the subordination of the supplier. The agreement should include provisions specifying the products covered, the contract term, territory, commissions, payment terms, obligations and responsibilities of the parties, grant of exclusivity and termination. If the agreement is silent as to exclusivity rights, the supplier would not be allowed to appoint another sales representative and the sales representative would not be allowed to represent another supplier in the same territory. The agreement should also limit the use of the supplier's trade name and trademark, to limit legal risks associated with the acts of sales representatives.

In addition to the above, an important statutory provision to consider is the indemnity payable upon termination of a sales representation agreement. The law sets a minimum termination indemnity payable to the sales representative calculated on the basis of the term of the agreement. Where a supplier terminates an agreement contemplating an undetermined period of duration, without just cause, the sales representative is entitled to a minimum indemnity of one-twelfth of all commissions paid or owed to the sales representative until the termination of the agreement. Furthermore, the supplier will have to give the sales representative a ninety (90) day written notice and will only be entitled to terminate the agreement if the period during which the sales representation activities were performed is compatible with the investments made by the sales representative. Where an agreement for a fixed term is terminated, without just cause, prior to the completion of such term, the sales representative is entitled to a minimum indemnity of the average monthly



commissions paid to the sales representative multiplied by one half of the number of months between the date of termination and the scheduled completion of the fixed term.

The best strategy to address statutory indemnity provisions, while encouraging satisfactory sales performance standards, is to set minimum sales targets, which if not achieved constitute just cause for termination of the agreement. The termination of a sales representation agreement for just cause does not trigger indemnity obligations.



Establishment of a Brazilian Subsidiary

Foreign investors often establish a direct local presence through a Brazilian subsidiary, which provides them direct control over activities, management and personnel. In addition to market and management considerations, foreign investors may choose to establish a Brazilian subsidiary alone, rather than enter into a joint venture with or acquire an existing local company, to avoid labor and tax succession concerns associated with such transactions.

Brazilian laws provide for several types of company forms, of which the *Sociedade Limitada* (*Limitada*) and the *Sociedade Anônima* (*S.A.*) are most commonly used. Other company forms have enjoyed virtually no acceptance in practice, especially because most of them provide for unlimited liability of their partners.

The election of the company form most suited to the proposed activities should take into account the desired ownership structure, legal flexibility, cost and confidentiality considerations, among other factors, as specific circumstances may warrant. For instance, a *Limitada* may not be adequate in the case of a joint venture, since certain fundamental matters affecting the company require approval from partners representing at least 75% percent of its capital. On the other hand, and in contrast to the *S.A.*, the *Limitada* is not required to publish financial records and statements, which results in cost savings and confidentiality benefits for the *Limitada*. Unlike the *Limitada*, however, the *S.A.* may issue securities and other negotiable instruments. The *Limitada* and *S.A.* are accorded the same treatment under Brazilian tax legislation; however, the home tax jurisdiction of investors may treat *Limitada* and *S.A.* company profits and losses differently.

The *Sociedade Limitada*

The *Sociedade Limitada* (commonly referred to as a *Limitada* and translated as a limited liability company) is statutorily governed by Sections 1052 to 1087 of the Brazilian Civil Code and, in the case of omissions, depending on the language of the articles of association, by Law 6,404 of December 12, 1976, as amended (the Corporation Law), or by the regulations of the *Sociedade Simples*, which is a new type of company regulated in Sections 997 to 1038 of the Brazilian Civil Code.



Formation

A *Limitada* needs at least two partners, also known as quotaholders, whether or not Brazilian resident individuals or legal entities. To constitute a *Limitada*, the partners must sign a *contrato social* (articles of association) and comply with the registration requirements of the state in which the head office of the company is to be located. Since the formation and operation of companies is governed by federal law, the state in which the company's head office is located will usually depend on practical or tax considerations. A partner who is not a Brazilian resident must appoint a Brazilian resident as its attorney-in-fact, with powers to receive service of process on behalf of the nonresident partner with respect to company matters.

The articles of association and any amendments thereto may be drafted to suit the purposes of the *Limitada*, but must be written in Portuguese and include: (i) the name of the partners and their personal data, (ii) the name of the *Limitada*, which must include its purpose and the expression "*Limitada*" (or its abbreviated form "*Ltda*") and cannot be identical or similar to the name of a pre-existing company, (iii) the address of the head offices, (iv) the company's purposes, which must be clearly described, (v) the company's duration, which may be determined or undetermined, (vi) the company's capital, whether or not it is fully paid and, if not, the payment term therefor, and (vii) each partner's participation in the capital and that the responsibility of each partner is limited to the company's subscribed capital. Other provisions may be included if the partners so desire, such as: (i) regulations on the transfer of quotas, (ii) fiscal board, (iii) corporate actions that require prior approval from the partners, in addition to those specified by law, and (iv) authorization for the exclusion of minority partners from the company, if due cause is present.

Unless the *Limitada* is not organized as a business enterprise, the partners must register the articles of association with the competent state commercial registry. In order to have legal effect retroactive as of the date of execution with respect to third parties, the articles of association must be registered within thirty days of execution.

Capital

The capital of a *Limitada* is represented by units called "quotas", with no issuance of certificates of ownership. The capital is denominated in Brazilian currency and recorded in the articles of association, as amended from time-to-time to reflect any assignment and transfer of quotas and capital increases and reductions. No minimum capital requirement exists. However, where the company seeks to appoint a nonresident individual to a management position, the individual must obtain the required resident status in Brazil through a permanent visa, which in turn triggers minimum capital requirements.

Each partner must subscribe for quotas, which may be paid upon subscription or subsequent thereto, in cash or moveable or immovable property. The value of moveable or immovable property contributions are not subject to expert appraisal, and may be established by mutual agreement of the partners. However, all partners are jointly liable for five years with respect to any deficiency between the actual value of the assets



and the value attributed to them at the time of the capital contribution. A partner who fails to fully pay for quotas to which it subscribed in accordance with the terms provided in the articles of association may: (i) be removed from the *Limitada* upon reimbursement of any amounts it has previously paid, (ii) be charged for losses and damages, or (iii) have its participation in the company reduced to those quotas already paid for, always at the discretion of the remaining partners.

The capital of a *Limitada* may only be increased once all quotas previously subscribed have been paid-up. The partners are entitled to preemptive rights in the subscription of new quotas, to be exercised within thirty (30) days from the date of the resolution approving the capital increase. The capital may be reduced if: (i) the company has registered losses, or (ii) it is deemed excessive in relation to the company's activities. In the latter case, unsecured creditors may object to the capital reduction within a period of ninety (90) days, in which case the reduction may only be effected if the corresponding credits are previously paid or if the relevant amounts are deposited with a competent Court for the benefit of the objecting creditor.

Depending on the articles of association, profit distributions may be effected at the discretion of the partners both as to time and amount. The law does not require profit distributions to partners to be effected in proportion to their quota interests. However, this flexibility does not benefit partners seeking to effect foreign remittances of profit distributions. The interest of a foreign investor in a company is recorded through a foreign investment registration with the Central Bank of Brazil (*Banco Central do Brasil* or BACEN), which entitles the investor to effect foreign remittances of company profit distributions in proportion to or less than, but not more than, the quota interest recorded therein.

Quota transfers and assignments among the partners and/or to third parties are subject to the provisions of the articles of association. In the absence of specific provisions in the articles of association, quotas may be freely transferred among partners, and may also be transferred to third parties if there is no objection from partners representing at least one-fourth of the capital. Changes in capital ownership and levels are effected by an amendment to the articles of association registered with the competent state registry.

Rights and Obligations of Partners

As a matter of internal relationship among partners, each partner is responsible for the payment of its subscribed quotas. With respect to claims of third parties, however, all partners are jointly liable for the entire amount of the corporate capital until it is fully paid. Personal unlimited liability may attach to a partner who votes for or consents to a resolution contrary to the articles of association or the law.

The law establishes that the following matters must be decided by the partners pursuant to the following voting requirements:

- (a) appointment of managers that are not partners: unanimous approval until capital is fully paid in, and partners representing two-thirds of the capital thereafter;

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- (b) removal of managers that are partners and have been appointed in the articles of association: partners representing two-thirds of the capital, unless otherwise established in the articles of association;
 - (c) amendments to the articles of association: partners representing three-fourths of the capital;
 - (d) merger, consolidation, dissolution and termination of liquidation procedures: partners representing three-fourths of the capital;
 - (e) appointment of managers in a separate document outside the articles of association: partners representing more than one-half of the capital, unless the manager is not a partner, in which case item (a) above will apply;
 - (f) removal of managers: partners representing more than one-half of the capital, unless the manager is a partner appointed in the articles of association, in which case item (b) above will apply;
 - (g) manager compensation if not established in the articles of association: partners representing more than one-half of the capital; and
 - (h) court-relief proceedings: partners representing more than one-half of the capital.

Such voting requirements may be increased, but not decreased, by contractual provisions included in the articles of association. Other matters submitted to the partners must be approved by a majority of votes, unless otherwise established in the articles of association.

A partner who objects to an amendment to the articles of association or to a merger is entitled to withdraw from the *Limitada*. If the articles of association are silent, the amount payable to the dissenting partner will be the book value of its quotas, determined on the basis of a special balance sheet as at the date of the action that triggered the right of withdrawal, which amount must be paid in cash within ninety (90) days.

Unless approved in writing by all partners, all matters to be decided by partners must be submitted for approval in a partners meeting. Such meetings may take the form of more rigid general meetings (*assembléias*) or more flexible meetings (*reuniões*). The former is mandatory for companies with more than ten partners. The latter may be used by all other companies. Using *reuniões* provides more flexibility because they can be freely regulated in the articles of association, while *assembléias* must follow mandatory legal requirements, including for instance the publication in newspapers of notices calling each meeting. Once again, it is important to note that neither *assembléias* nor *reuniões* need to be held if all partners approve in writing each applicable matter.

Annual partners meetings must be held within the first four months following the end of the fiscal year to consider and review financial statements and management accounts, appoint new managers, if applicable,



and decide on any other matters included in the agenda. Copies of the financial statements must be forwarded to the partners at least thirty days prior to the annual meeting. Any other partners meetings may be held if and when company interests so require.

Management

Management of the *Limitada* may be vested in one or more resident individuals, appointed in the articles of association or in a separate document. Managers may or may not be partners, but in the latter case the articles of association must expressly authorize the appointment of non-partner managers. Whenever the articles of association establish that all partners will be managers of the company, such attribution does not apply automatically to new partners. The *Limitada* is liable for all acts performed on its behalf by managers acting within the scope of their powers.

Fiscal Board

The *Limitada* may have a fiscal board comprised of three or more members, but such board is not mandatory. The members of the fiscal board must be resident in Brazil, may be partners or not, and must be elected at the annual partners meeting. The responsibilities of the fiscal board include: (i) the review, at least quarterly, of the books and accounts of the company, (ii) denouncing any mistakes, fraud or crimes relating to company matters, and making suggestions in the interest of the company, (iii) calling annual partners meetings when managers fail to do so, and (iv) exercising certain acts during the liquidation of the company.

The *Sociedade Anônima*

The *Sociedade Anônima* (commonly referred to as an *S.A.* and translated as a corporation), is governed by the Corporation Law, comprised of over three hundred provisions. In comparison to the *Limitada*, the extensive provisions governing the *S.A.* provide a more detailed regulatory framework for corporate activities, management and shareholder relations, greater financing flexibility and enhanced transparency, although at the cost of increased administrative and publication costs associated therewith.

Legal Nature

The *S.A.* is a legal entity whose capital is divided into units called shares and the liability of its shareholders is limited to the issue price of subscribed shares. An *S.A.* may be *aberta* (publicly-held) or *fechada* (privately-held) depending on whether or not its securities, including shares, are traded on the over-the-counter market or the stock exchange. The *S.A.* must be for profit and its corporate purposes must be specifically and fully described in its *estatuto social* (by-laws). The company's name must include its purpose and the expression "*Companhia*" or "*Sociedade Anônima*" (or its abbreviated form "*S.A.*") and cannot be identical or similar to the name of a pre-existing company.



Formation

An *S.A.* is constituted by the public or private subscription of the company's capital by at least two individuals or legal entities or any combination thereof, whether or not resident in Brazil. Where all or part of the issue price of the capital is to be paid in cash, a minimum of 10 percent of such amount must be paid in cash upon the act of subscription. All capital paid-up in cash must be deposited at an authorized financial institution within five days of the company's receipt of issue proceeds.

Public subscription is subject to the prior registration of the issue with the Brazilian Securities Commission (CVM). The distribution of the company's shares must be effected by a financial institution. Upon full subscription of the capital, the formation of the *S.A.* must be approved at a general shareholders meeting. Private subscription is subject to the approval of subscribers of capital at a general shareholders meeting or to the execution of a public deed, including approval of the proposed by-laws of the company.

The by-laws of the company must specifically and fully define the company's purposes and capital value in Brazilian currency. It should also include provisions on the number and classes of shares, where multiple classes exist, including corresponding rights and obligations, the management structure and operation, the shareholders meetings, profit distributions and form of dissolution. Once approved, the by-laws must be registered and published, prior to the initiation of the company's activities. Corporate documents of the *S.A.* are registered with the competent state commercial registry. The *S.A.* is required to establish and maintain corporate books, including the Registered Share Book and Registered Share Transfer Book, which may be substituted by authorized records of an issuing agent, where one exists, and books of Minutes of General Shareholders Meetings, Shareholder Attendance, Minutes of Meetings of the Board of Directors, and Minutes and Opinions of the Fiscal Board.

Capital

The capital of the *S.A.* may be fixed or authorized and its shares may be issued with or without par value. Share ownership is evidenced through recordation in the Registered Share Book or through a statement issued by a financial institution acting as depositary agent, if any. Where the by-laws establish a fixed capital, increases are subject to prior approval of the general shareholders meeting and must be effected through an amendment to the by-laws. Such approval and amendment to the by-laws are not required where increases are within the authorized capital limit established in the by-laws. Share subscriptions must be paid in cash or assets of a value determined by expert appraisal and approved by the shareholders.

The shares of the *S.A.* may be divided into several share classes based on the rights and obligations attached to each specific class. A publicly-held *S.A.* may only have one class of common shares, unlike the privately-held *S.A.*, which may have more than one class of common shares that may be convertible into preferred shares, restrict ownership to Brazilian citizens or grant a separate right to appoint members of management bodies. The *S.A.*, both publicly-held and privately-held, may have more than one class of preferred shares, with or without voting rights. For *S.A.* incorporated after October 31, 2001 (date of approval of a major revision of the



Corporation Law), the number of non-voting or restricted voting preferred shares cannot exceed 50 percent of the total number of issued shares. The same limit of 50 percent must also be observed by a privately-held *S.A.* already in existence on October 31, 2001 that goes public after such date. Corporations already in existence on October 31, 2001 are allowed to keep a two to one ratio between: (i) preferred shares with non-voting rights or restricted voting rights and (ii) voting shares.

Shares of a publicly-held *S.A.* may only be traded after 30 percent of the issue price is paid-up. Shares of a privately-held *S.A.* cannot be publicly traded, and their sale may be restricted in the by-laws, although the sale of shares cannot be restricted altogether nor made subject to the discretion of the management bodies or majority shareholder(s). To be perfected, liens or encumbrances created on the shares must be recorded in the relevant share registry book or with the depositary institution responsible for registering the shares of the company.

In addition to common and preferred shares, the *S.A.* may also issue other types of securities, such as *partes beneficiárias* (beneficiary parts), *debêntures* (debentures) and *bônus de subscrição* (subscription rights). Beneficiary parts must be issued in a single class without par value and can only be issued by a privately-held *S.A.* It entitles holders thereof (i) to a share not exceeding one tenth of the company's annual net profits, and (ii) to inspect the acts of officers.

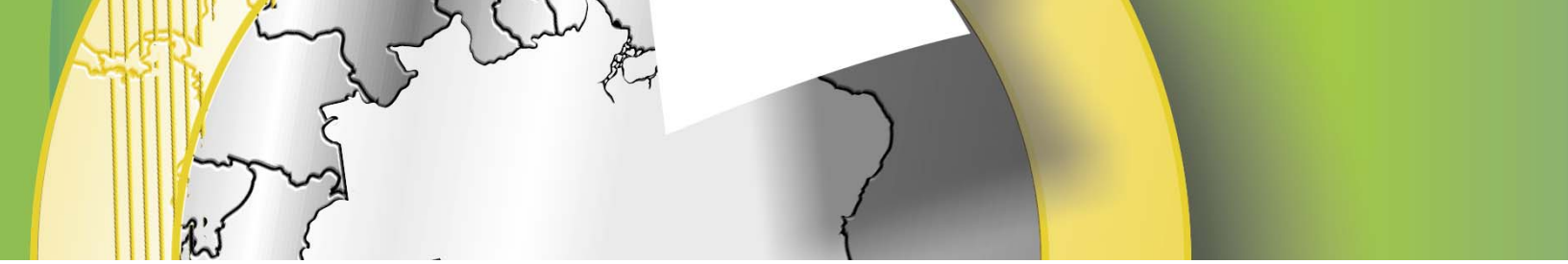
Debentures represent an indebtedness obligation of the company towards debenture holders. They must be issued with par value and may have multiple series. A debenture indenture must be issued indicating the rights granted to debenture holders, any security interests and other terms and conditions of the issue.

Debentures may be secured by a specific security interest or by a general floating lien, or may be unsecured or subordinated to the other indebtedness of the company. Debentures may be convertible into shares of the company. Holders of debentures that are publicly traded must be represented by an *agente fiduciário* (trustee), whose duties are set forth in the debenture indenture and in the law.

Subscription rights entitle holders to subscribe for company shares. Such instruments may be issued by an *S.A.* with authorized capital and their issuance must be approved at a general shareholders meeting or by the board of directors, as per the by-laws of the *S.A.*

Rights and Obligations of Shareholders

In addition to general rights and obligations specified in the Corporation Law, specific rights and obligations of common and preferred shareholders may be provided for in the by-laws. Under the Corporation Law, shareholders are entitled to participate in the company's profits and proceeds of dissolution, may inspect the business of the company, have pre-emptive rights in the subscription of new shares and other securities that are convertible into shares (save for certain exceptions if the *S.A.* is publicly-held), and have certain dissent and withdrawal rights. Further, the shares of each class must confer the same rights on all their holders. The company is also required to comply with shareholder agreements on file at its head office, which may govern



the purchase and sale of shares, rights of first refusal in share purchases, voting rights and the exercise of control over the company. The existence of a shareholders agreement must be reflected in relevant company registries in order to be enforceable against third parties.

Shareholders may generally exercise their rights and obligations personally or through a qualified attorney-in-fact. However, where the shareholder is not a resident in Brazil, it must appoint a representative in Brazil empowered to receive service of process.

Each common share entitles its holder to one vote in resolutions taken at general shareholders meetings. However, the by-laws may limit the number of votes of each shareholder. Preferred shareholders may or may not have restricted voting rights. Non-voting preferred shareholders entitled to receive fixed or minimum dividends, however, will acquire voting rights if the company fails to pay such dividends for a period specified in the by-laws, not to exceed three consecutive fiscal years.

Annual shareholders meetings must be held within the first four months after the end of each fiscal year to consider and review financial statements, decide upon the use of profits and distribution of dividends and to elect managers and members of the fiscal board, where such exists. Preferred shareholders may also be granted the right to elect, by separate vote, one or more members of management bodies. General shareholders meetings are held to consider any matters outside the scope of the annual shareholders meetings, such as amendments to the by-laws, which may also be subject to the approval of preferred shareholders in specific circumstances, removal of managers and members of the fiscal board, issuance of debentures, suspension of voting rights, appraisal of assets contributed as capital, and transformation, merger, consolidation, spin-off, dissolution or bankruptcy of the company. Quorum for the installation of meetings ranges from one quarter to two-thirds of the capital, provided that there is no minimum quorum following the second call for the meeting. In order to approve a resolution, an absolute majority of votes cast is generally necessary, unless otherwise specified by law or in the by-laws. Further, the by-laws of a privately-held *S.A.* may provide for a higher decision-making quorum for certain matters identified therein. Minutes of all shareholders meetings must be published.

The right of dissent is available to shareholders prejudiced by the creation of preferred shares or a disproportionate increase in existing classes, unless contemplated in the by-laws, a change in the redemption or amortization terms of one or more classes of preferred shares or the creation of a new, more favored class. Dissent is also allowed in other circumstances, including the reduction of a compulsory dividend or change in corporate purposes and, under certain circumstances, where the company is merged with or consolidated into another company or comes to participate in a group of companies. The calculation of the value of the shares may be established in the by-laws, subject to a minimum value based on the book value of the company as recorded in the latest financial statements.

As a general rule, all shareholders are entitled to a compulsory dividend specified in the by-laws, subject only to the existence of sufficient profits in the fiscal year. Where the by-laws are silent, shareholders are entitled to half of the fiscal year net profit increased or decreased by amounts directed to: (i) constitute a legal reserve, and (ii) the establishment of a contingency reserve net of any reversals of contingency reserves for previous



fiscal years, provided that payment of such dividend may be limited to the amount of realized profits for the fiscal year as long as the difference is recorded into a reserve of unrealized profits. Amounts so recorded in the reserve of unrealized profits must be distributed as dividends when the profits are realized, provided that they have not been absorbed by subsequent losses. However, a privately-held *S.A.* which is not controlled by a publicly-held *S.A.*, as well as any publicly-held *S.A.* which only raises funds with the public through the issuance of non-convertible debentures, are not required to pay compulsory dividends and may fully retain profits upon unanimous approval at a general shareholders meeting. Shareholders are also entitled to participation in the net proceeds of dissolution.

Preferred shareholders whose shares are not admitted for trading in the securities market are entitled to: (i) priority distribution of fixed or minimum dividends, which may be cumulative or not, (ii) priority in the reimbursement of capital upon liquidation of the company, with or without a premium, or (iii) a combination of items (i) and (ii).

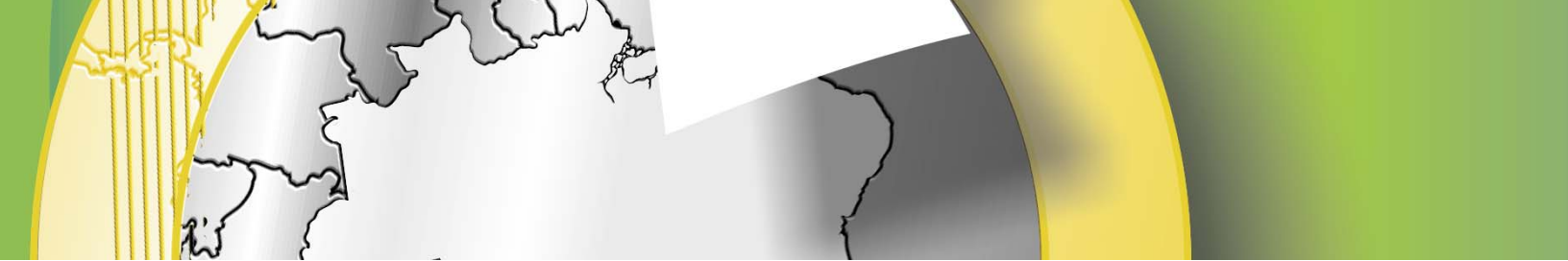
Preferred shares admitted for trading in the securities market must have at least one of the following preferences or advantages: (i) the right to share in the distribution of cash dividends equal to at least 25 percent of the annual net profits, with priority in respect of an amount of such dividends that is equal to at least 3 percent of the net worth value of each share, and with the right to participate under equal conditions with the holders of common shares after distribution to the holders of common shares of a cash dividend equal to that distributed to the holders of preferred shares, (ii) the right to receive cash dividends in an amount at least 10 percent higher than the dividends distributed to the holders of common shares, or (iii) the right to receive cash dividends at least equal to the dividends distributed to the holders of common shares, coupled with a tag along right in the case of a sale of control, at a price equal to at least 80 percent of the price paid for the controlling shares.

Management may be granted the right to participate in profits where the by-laws of the company provides for a compulsory dividend of 25 percent or more of net profits, limited to an amount fixed by law.

The liability of shareholders is limited to the issue price of their shares. If a shareholder fails to pay for its shares, the company may initiate an action to collect amounts owed or order a sale of the shares. The shareholders are also obligated to exercise voting rights in the best interests of the company and to abstain from voting where a conflict of interest exists, subject to liability for damages suffered by the company. Controlling shareholders are further obligated to exercise their powers towards the accomplishment of company objectives and have obligations and responsibilities vis-à-vis the other shareholders, employees and stakeholders, whose rights and interests they must respect.

Management

Management of a company is vested in a *conselho de administração* (board of directors) and a *diretoria* (executive officers). The board of directors is optional in the case of a privately-held *S.A.*, provided that its by-laws do not specify an authorized capital level. The board of directors must be comprised of at least three individual shareholders, who may or may not be resident in Brazil. Non-resident directors must be



represented in Brazil by an attorney-in-fact. Members of the board of directors are elected at a general shareholders meeting and are known as *conselheiros*. Similarly to a U.S. board of directors, the board of directors of an S.A. is empowered to direct the company's business; elect and remove the company's officers, establish their duties and responsibilities and supervise their activities; inspect company records, documents and contracts; call general shareholders meetings as deemed appropriate or required; comment on reports of the officers and their accounts; provide prior commentary on company acts or contracts, as provided for in the by-laws; approve certain issuances of shares; decide on the disposal of assets, encumbrances, guarantees and obligations assumed on behalf of third parties, unless the by-laws provide otherwise; and select and dismiss independent auditors, if any.

Financial statements, including an annual balance sheet, accumulated profit and loss statement, income statement and source and application of funds statement, must be prepared under the direction of the board of directors, approved by the shareholders and published in the official gazette and one other widely circulated newspaper. The financial statements of a publicly held S.A. must also be audited. There are certain exceptions to the publication requirement for a privately-held S.A. with less than twenty shareholders and a net capital of less than one million Reais.

Each S.A. must have at least two executive officers (*diretores*), resident in Brazil, who may or may not be shareholders. Executive officers must be elected by the board of directors, if one exists, or otherwise at a general shareholders meeting. Up to one-third of the members of the board of directors may also serve as executive officers. The duties of the officers may be established by the board of directors or in the by-laws. Unless provided otherwise, any officer has the authority to represent the company and practice all acts necessary for its regular operation.

Neither members of the board of directors nor officers are personally liable for the obligations contracted in the name of the company in the regular course of business; however, they are liable when they act beyond the scope of their powers (*ultra vires*), contrary to the law or the by-laws, or negligently.

Fiscal Board

The by-laws of a company must indicate whether a fiscal board will exist on a permanent basis or only become operational upon shareholder request. The members of the fiscal board, comprised of three to five individuals resident in Brazil, who need not be shareholders, are elected at a general shareholders meeting. Under the Corporation Law, the responsibilities of the fiscal board, include the duty to: (i) inspect the acts of management to ensure compliance with the law and the by-laws, (ii) comment on the annual management report and proposals to be submitted to general shareholders meetings, (iii) denounce to the executive officers or the board of directors or, upon their omission, to the general shareholders meeting, any mistakes, wrongdoings or crimes relating to corporate matters, and make suggestions in the interest of the company, (iv) call general shareholders meetings, where management bodies fail to do so, (v) review and comment on financial documentation and (vi) perform these functions during a liquidation.



Other Provisions

The by-laws of an S.A. may establish other corporate bodies, in addition to those mentioned above. The Corporation Law also includes specific provisions on *transformação* (transformation, the change in corporate form), *fusão* (merger), *cisão* (spin-off), quasi-government corporations, related corporations, wholly-owned subsidiaries, change of control, corporate groups and consortia.



Joint Ventures and Mergers and Acquisitions

The selection of joint ventures and mergers and acquisitions as alternatives to the exercise of activities through a newly created, wholly-owned Brazilian subsidiary is primarily motivated by business factors. From a legal perspective, the decision to establish a joint venture with or acquire an existing Brazilian company should be made only after due diligence investigations and an assessment of the legal risks associated with the relevant business, particularly tax and labor.

Joint Ventures

Joint ventures are normally structured through the establishment of a company, taking the form of a *Limitada* or privately-held *S.A.*, the selection of which should consider, among other factors, the ownership and management structure and confidentiality concerns. In the establishment of a joint venture, the preliminary understandings of the parties on various aspects of the proposed business venture and its structure may be recorded in a preliminary agreement (usually referred to as a memorandum of understanding), which provides for further exclusive negotiations and due diligence investigations. Unless explicitly provided otherwise, a memorandum of understanding is binding on the parties thereto.

Upon the successful completion of negotiations, the joint venture company is created (as described above in section *Establishment of a Brazilian Subsidiary*). The articles of association or by-laws of the joint venture company will then govern the relationship between the parties, although a separate instrument may also be executed to further regulate such relationship in the form of a shareholders/quotaholders agreement.

Given that the underlying joint venture vehicle is a Brazilian company, legally required corporate documents must be prepared and executed in Portuguese and are subject to Brazilian law. Although the same requirement is not necessarily applicable to other joint venture related documents, such documents should nevertheless be drafted in Portuguese by Brazilian qualified counsel, executed in Portuguese and made subject to Brazilian law, in the best interests of the foreign investor. English and other foreign language documents are legal and enforceable in Brazil without any registration or other filing or payment requirements. However, any and all foreign language documents submitted to a Brazilian court or any other government and/or public authority must be translated into Portuguese by an official translator and registered with the competent Registry of Deeds and Documents.

Mergers and Acquisitions

Merger and acquisition transactions commence with preliminary negotiations between the parties on purchase terms and conditions, representations and warranties, non-compete and indemnification provisions, which may be reflected in a memorandum of understanding providing for further exclusive negotiations and due



diligence investigations. As a preliminary, although important, discussion point, the parties to the transaction should consider whether to effect it through an asset or share acquisition, at which time it should be noted that the outcome of due diligence investigations may determine the most cost-effective alternative.

In the case of a share acquisition, during this initial stage, the articles of association of the target *Limitada* or the by-laws of the target *S.A.*, as well as any valid quotaholders or shareholders agreements, as the case may be, should be reviewed for any restrictions on the assignment and transfer of quotas or shares, respectively, including rights of first refusal. Upon the successful completion of negotiations, the manner in which the acquisition is effected will depend on the company form of the target company.

Acquisition of a *Limitada*

The acquisition of a *Limitada* is effected through the approval and registration of an amendment to the articles of association of the target company to reflect the assignment and transfer of quotas to the new partners. Concurrent with such amendment, a detailed quota purchase and sale agreement is usually executed, including purchase terms and conditions, confidentiality and non-compete provisions and, based on due diligence investigation results, representations and warranties, indemnification clauses and guarantees, among other case specific provisions.

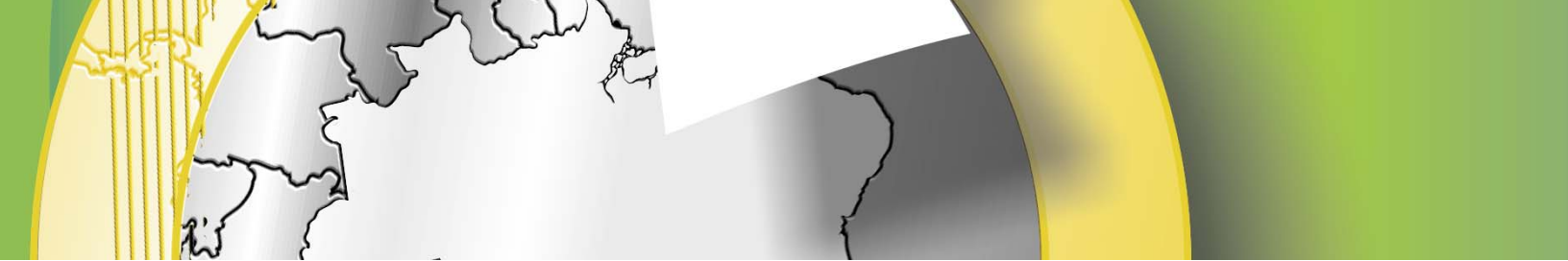
At completion, the purchaser may also substitute management of the company through the same amendment to the articles of association which effected the object quota transfer and sale, or through the revocation of a pre-existing instrument of appointment and execution of a new instrument of appointment designating new managers.

Taking into account the voting requirements of a *Limitada* explained above (under *Establishment of a Brazilian Subsidiary*), full control is acquired only if the investor acquires at least 75 percent of the company capital.

Acquisition of an *S.A.*

The acquisition of a privately-held *S.A.* is effected through the approval and execution of a share transfer in the Registered Share Transfer Book, or in the case of shares represented by a deposit with an authorized issuing agent, upon notice to the issuing agent. Concurrent with the execution of the transfer, a share purchase and sale agreement is usually executed, including purchase terms and conditions, confidentiality and non-compete provisions and, based on due diligence investigation results, representations and warranties, indemnification clauses and guarantees, among other case specific provisions.

The acquisition of a publicly-held *S.A.* may be effected privately between the interested parties, in which case the acquisition process will be similar to the acquisition of a privately-held *S.A.* described above, or through a public offer. The public offer must be made through a financial institution, which will guarantee compliance with the obligations of the offeror. The shares subject to the offer must, if acquired, give the purchaser a controlling interest.



The acquisition of a publicly-held *S.A.* must be communicated to the CVM and disclosed to the market as a material event. In addition, the purchaser of the controlling stake is required to make a tender offer for the acquisition of the remaining common shares of the company for a price equal to at least 80 percent of the price paid for the controlling shares.

The purchaser may offer minority shareholders the option to maintain their shares in the company in exchange for receiving an amount equivalent to the difference between the market value of the shares and the price paid for the controlling shares.

The acquisition of companies in certain sectors, including those in the insurance and telecommunications sectors, and institutions regulated by BACEN, may be subject to specific approvals.

Due Diligence

The main purpose of due diligence investigations is to allow the prospective purchaser to better assess the value of proposed transactions and identify related contingencies. In addition, due diligence results should be taken into account in the drafting of specific provisions in the transaction documents, especially when it is necessary to address any issues verified during the investigations. Several mechanisms are available for such purpose, including the inclusion of broad contractual representations and warranties in favor of the purchaser, escrow arrangements, holdbacks and staggered purchase price installments. The investigations are also useful in the determination of steps to be taken by the purchaser when the transaction is completed, both in terms of remedying any identified problems and planning for future administrative adjustments.

The scope and length of the due diligence process will depend on the circumstances of each transaction. Various aspects of the target company may be analyzed, and many times a separate investigation by an auditing firm is conducted simultaneously with the legal investigation conducted by qualified attorneys.

In Brazil, certain public records can and should be checked during a due diligence. The ownership of real estate, for instance, is reflected in records kept by the appropriate Real Estate Registry. Corporate documents such as by-laws and articles of association can be obtained from the competent Board of Trade. Additionally, Brazilian courts, including labor and tax courts, are prepared to issue certificates indicating any pending lawsuits involving the target company.

In addition to the examination of public records, various documents are requested from the target company and then analyzed by the attorneys representing the prospective purchaser. Although such investigations are similar to those conducted in other countries, special attention should be devoted to certain topics in light of Brazilian laws. The following items contain a brief description of relevant topics in the areas of tax, labor, commercial succession, and environmental protection.



Tax

Due to the complexity of the tax system and, more recently, to successful constitutional challenges to recent amendments to tax and social security laws, outstanding taxes may be the object of tax disputes, which are commonplace. Therefore, an assessment of tax contingencies will have to take into account the likelihood of success of such tax disputes. Furthermore, the existence of tax debt re-negotiation plans between the target company and tax authorities should also be confirmed and reviewed.

In the case of a share acquisition, the purchaser will naturally be concerned with any outstanding tax obligations of the target company. But when the transaction is structured as an asset purchase, tax succession becomes a major concern. In summary, where the assets purchased fall within the definition of commercial, industrial or professional establishment succession results. Specifically, the National Tax Code (CTN) provides that an individual or legal entity is liable for taxes owed or later assessed related to the commercial, industrial or professional establishment or *fundo de comércio* (goodwill). Establishment is broadly defined to mean the instrumentality through which the activities that were the object of the acquisition are exercised, where the purchaser continues to exercise related commercial activities, under the same or another corporate purpose or name. The purchaser is fully liable where the seller ceases to exercise the activities that were the object of the acquisition, or secondarily liable where the seller continues to exercise the activities that were the object of the acquisition or initiates new commercial, industrial or professional activities within six months of the acquisition, whether or not related to the activities that were the object of the acquisition.

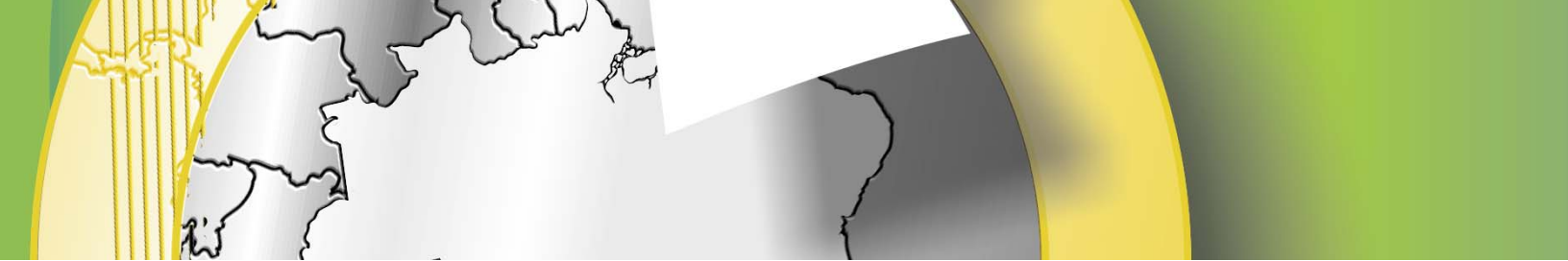
Labor and Employment

A thorough review of the labor and employment records of the target company must be conducted, particularly the registration of employees and payment of all labor liabilities. In this review process it is important to evaluate the nature of the employment relationship in practice, as substance over form will prevail in the determination of whether or not an employment relationship exists.

Neither joint ventures nor acquisitions require prior employee approval. Nevertheless, in the case of joint ventures, due diligence should also consider the assets of the partners or shareholders of the joint venture company, since labor authorities may consider the parties to a joint venture company to be part of the same economic group, and therefore jointly and severally liable for each other's labor-related debts.

Commercial Succession

In addition to tax and labor matters, the acquisition of assets could also raise succession concerns in relation to commercial agreements if such assets are deemed to constitute an establishment. According to the Brazilian Civil Code, an establishment is defined as a set of assets organized by an entrepreneur or a legal entity to produce goods or services. In other words, a particular group of assets will be considered an establishment if it represents an independent going-concern.



Since the Brazilian Civil Code was recently enacted, there are still no court precedents clarifying the extent of the purchaser liability with respect to commercial indebtedness and obligations of the seller. However, a conservative interpretation indicates that the creditors of a seller may be entitled to seek payment directly from the purchaser for past commercial liabilities related to the relevant assets, at least with respect to liabilities duly accounted for by the seller.

Environmental Protection

Environmental due diligence confirms that the target company possesses all required operating licenses and permits and that its activities are conducted in compliance with generally applicable environmental regulations. In general, government licenses attach to the company, and therefore are not affected by a change in control in the target company. A separate environmental audit may also be conducted by environmental consultants. In assessing environmental risks, it should be noted that liability for environmental damage has increased significantly with the enactment of recent legislation, which defines certain acts as constituting crimes against the environment and provides for administrative and criminal sanctions.

Antitrust Provisions

General View

Although competition legislation exists in Brazil since 1962, actual antitrust implementation only started in 1994, with the publication of Law 8,884 (the “Competition Law”).

The Brazilian antitrust system is currently formed by three agencies: (i) the Administrative Council for Economic Defense (CADE), the independent antitrust commission; (ii) the Secretariat for Economic Monitoring of the Ministry of Finance (SEAE), in charge of economic investigations; and (iii) the Secretariat for Economic Law of the Ministry of Justice (SDE), in charge of legal investigations of anti-competitive practices. Although CADE has sole rule-making authority, all three agencies participate in enforcement.

The Competition Law, a complex act with 93 sections dealing with both conduct and review of mergers, is complemented by a series of Resolutions issued by the three agencies to regulate certain areas not covered by the law or to clarify procedural aspects of antitrust enforcement.

In general terms, Brazilian law follows the U.S. competition law model, but in Brazil there is no bar on closing and no mandatory waiting period, thereby allowing the parties to close the transaction at their own risk. It is important to note that, although transactions may be closed and implemented before clearance, CADE has the discretionary power to impose whatever measures it deems necessary to remedy any anti-competitive impacts resulting from a given transaction.



Thresholds for Mergers and Acquisitions

The legal thresholds for notification requirements are either (i) a combined market share of 20% or (ii) a turnover in Brazil by any of the parties in excess of R\$ 400 million.

All kind of mergers, acquisitions and associations, including joint ventures, are affected by the Competition Law, provided they produce effects in Brazil and any of the two thresholds established by the law are met. In this particular, it is important to note that effects are usually interpreted by the agencies very broadly, including deals in which any of the parties has revenues in Brazil solely derived from export sales in very small amounts.

Responsibility and Penalties

The Competition Law makes no distinction between parties to a deal. Therefore, all parties are responsible for filing (one filing per deal only), and any party can be punished for non compliance. In practical terms, the authorities normally select a party to apply monetary sanctions based on their belief that enforcement against such party will be more effective and readily available.

Notifications must be submitted to the authorities within 15 business days as of the execution of the first transaction document by the parties. Filing deadlines are non-extendable, and penalties for failure to notify or late notification vary from R\$ 60,000 to R\$ 6 million, although average penalties recently imposed by CADE on late notifications generally amount to R\$ 180,000.



Foreign Capital Regulations

The registration of foreign capital with the Central Bank of Brazil (*Banco Central do Brasil* or BACEN), is provided for by Law 4,131 of September 3, 1962 and Law 4,390 of August 29, 1964, guaranteeing equal treatment of foreign and national capital.

Foreign capital is defined as goods, machinery and equipment, imported to Brazil without prior foreign capital disbursements, for the production of goods or services, as well as financial or monetary resources remitted to Brazil for application in economic activities, provided that, in both cases, such foreign capital belongs to individuals or legal entities resident, domiciled or with a head office abroad. The term *goods* has been defined to include trademarks, patents and technology transfers registered with INPI.

BACEN, through Circular 2,997 of August 15, 2000, created and regulated the declaratory electronic registration of direct foreign investments. According to such regulation, direct foreign investments in Brazil must be registered electronically through the Module RDE-IED of the Online Information System of BACEN (SISBACEN).

Capital investments, repatriations and profit remittances related to foreign capital duly registered with BACEN may be effected at any time without prior authorization of BACEN, subject to compliance with applicable corporate and tax legislation.

In addition, pursuant to Resolution 2,770 of the National Monetary Council (*Conselho Monetário Nacional*), enacted on August 30, 2000, which amended and consolidated the regulations regarding loan transactions, both individuals and legal entities domiciled in Brazil are allowed to enter into loan transactions with creditors domiciled abroad and the corresponding funds may be remitted to Brazil without prior authorization from BACEN.

In addition, BACEN enacted Circular 3,027 on February 22, 2001, which established and regulated the declaratory electronic registration of (i) foreign loans, (ii) issuance of securities abroad, (iii) loans related to export transactions (securitization of export transactions) and (iv) pre-payments of export transactions with a maturity term of more than 360 days, by means



of the creation of specific items in the already existing Module RDE-ROF and its inclusion in the SISBACEN System.

The registration of such transactions must be effected by the borrower or by the issuer of securities, directly or through a representative, before the inflow of the corresponding funds into Brazil. After such inflow, the relevant schedule of payments of such loan transaction or issuance of securities must be registered, in order to allow the remittance abroad of payments of principal, interest, fees and commissions.



Taxation

Framework

The Brazilian tax system is regulated by the Federal Constitution and by the National Tax Code (CTN), both of which establish general tax rules applicable to the Federal Union, the States, the Municipalities, and the Federal District.

The Brazilian tax system comprises different categories of taxes, and the main ones may be classified as: (i) taxes on income and revenues, (ii) taxes on production and circulation of goods, and on services and cross-border trade, and (iii) taxes on financial operations.

Taxes on Income

Domestic companies must pay federal taxes imposed on all income, which is defined as the product of capital and labor, or a combination thereof, as well as on any and all gains whatsoever, defined as increases of a taxpayer's property which are not included in income.

Profits arising from activities carried out in Brazil or abroad (Brazil adopts a worldwide system of taxation) are subject to the Corporate Income Tax (IRPJ) and to the Social Contribution on Profits (CSL).

Companies are required to file an annual federal tax return for each calendar year (January 1 -December 31), even if the company adopts a different fiscal year for corporate purposes. Thus, the fiscal year for any company in Brazil for income tax purposes is always the calendar year.

In the case of a split off, merger or consolidation, the basis for ascertaining the applicable income tax is determined as from the date of the transaction.

Taxes on Revenues

Domestic companies must also pay to the federal government the Social Contribution for Financing of Social Security (COFINS) and the Contribution to the Social Integration Program (PIS). COFINS and PIS are contributions levied on a monthly basis on total revenues realized by a company, including financial revenues, but excluding revenues resulting from the participation of such Brazilian company in other companies. There are a certain number of admitted deductions depending on the activities developed by the company, and in certain cases the method for calculating PIS and COFINS may be similar to that of a value added tax.

Beginning on May 1, 2004, PIS and COFINS also apply to the importation of goods and services.



Taxes on Production and on Domestic or Cross-border Transactions

Taxes on domestic production and circulation of goods and services comprise the Federal Excise Tax (IPI), the State Value Added Tax (ICMS), and the Municipal Service Tax (ISS). Import and export transactions are subject to the Federal Import Tax (II), the Federal Export Tax (IE), IPI and ICMS. Their rates may vary according to the product or service in question, the applicable tax classification number, and the place where the transaction was performed.

For purposes of defining the tax rates of II and IPI in Brazil, goods are classified under the *Nomenclatura Brasileira de Mercadorias* (Brazilian Nomenclature of Goods). This classification is also followed for purposes of MERCOSUR rules (MERCOSUR Common External Rates).

Taxes on Financial Transactions

Financial transactions are subject to the Federal Contribution on Bank Account Transactions (CPMF) and the Federal Tax on Credit, Foreign Currency Exchange, Bonds and Securities Transactions and on Insurance Operations (IOF).

CPMF is generally levied on every debit on bank accounts and upon liquidation of financial investments in Brazil, at a rate of 0.38 percent.

Taxation of Certain Payments Abroad

Capital gains

As a general rule, capital gains earned by non-Brazilian residents are subject to income tax of 15 percent, to be withheld and paid by the Brazilian source, unless the beneficiary is resident in a tax haven jurisdiction, in which case a 25 percent rate will apply. Capital gains realized outside Brazil in transactions involving assets located in Brazil are subject to Brazilian income tax, even if the transaction only involves non-Brazilian residents.

Dividends

Dividends payable by a Brazilian company to its shareholders, in and outside of Brazil, are not subject to Brazilian withholding taxes.

Interest on shareholders' equity

In addition to the payment of dividends, in certain circumstances Brazilian companies may remunerate their shareholders by paying interest on shareholders' equity. The payment of interest on shareholders' equity triggers the application of withholding taxes at the rate of 15 percent, which rate is increased to 25 percent if the beneficiary is resident in a tax haven jurisdiction.



Interest

Payments of interest made by a Brazilian party to a resident outside of Brazil with respect to loan transactions are subject to withholding tax at a rate of 15 percent, which rate is increased to 25 percent if the beneficiary is resident in a tax haven jurisdiction, or such other lower rate as provided in any applicable tax treaty between Brazil and the country where the beneficiary of the payment is domiciled. Currently, only remittances of interest to Japan benefit from a reduced treaty rate of 12.5 percent.

Royalties and technical assistance (transfer of technology)

Fees, commissions and any other income payable by a Brazilian obligor to an individual, company, entity, trust or organization domiciled outside Brazil in connection with royalties or technical assistance agreements involving transfers of technology are subject to a withholding tax at the rate of 15 percent¹ or such other lower rate as provided for in any applicable tax treaty between Brazil and the country where the recipient of the payment is domiciled.

Transfer Pricing Rules

Cross-border transactions (import or export of goods, services and intangible properties) entered into between a Brazilian company and a related party abroad, or a party residing in a tax haven jurisdiction, must comply with transfer pricing regulations (arm's length standard - market price).

Related persons

Related persons are mainly classified as follows:

- (i) the parent company of the Brazilian entity, if the parent is domiciled abroad;
- (ii) a branch or subsidiary of the Brazilian entity, if the branch or subsidiary is domiciled abroad;
- (iii) an individual or legal entity, residing or domiciled abroad, when it holds at least 10 percent of the share capital or control of the Brazilian company;
- (iv) a legal entity domiciled abroad in which the Brazilian company holds at least a 10 percent participation or has voting control;
- (v) a legal entity domiciled abroad, which is under common corporate or administrative control with a Brazilian entity or where at least 10 percent of the share capital of each belongs to a common shareholder;
- (vi) a legal entity or individual, residing or domiciled abroad, that, jointly with the entity domiciled in Brazil, owns a controlling stake in a third legal entity;

¹ In addition to withholding tax, payments referring to royalties and technical assistance are subject to a contribution destined to fund the development of technological researches in Brazil. Such contribution, named CIDE (*Contribuição de Intervenção no Domínio Econômico*), is imposed at the rate of 10 percent and must be borne by the Brazilian company making the payment.



- (vii) an individual or legal entity resident abroad with which the Brazilian entity is associated by way of a consortium or co-ownership in any enterprise;
- (viii) an individual resident abroad who is a family member, or is related up to the third degree of kinship to, or is a spouse or companion of a director of, or who is associated with, the Brazilian entity; and
- (ix) the exclusive agent, distributor or concessionaire for the purchase and sale of goods, services or intangible properties of a resident or person domiciled abroad or in relation to whom the legal entity in Brazil acts as such.

Tax Haven Jurisdictions

Any jurisdiction that does not impose income tax or where such income tax is imposed at a maximum rate of 20 percent is deemed to be a tax haven. In addition, Brazilian tax authorities issued a list of jurisdictions considered to be tax havens for purposes of transfer pricing rules and imposition of higher withholding tax rates. Such list is not restrictive and, currently, comprises the following jurisdictions: Andorra; Anguilla; Antigua; Aruba; the Bahamas; Bahrain; Barbados; Barbuda; Belize; Bermuda; the British Virgin Islands; Campione D'Italia, the Cayman Islands; the Channel Islands (Jersey, Guernsey and Alderney); the Cook Islands; Costa Rica; Cyprus; Djibouti; Dominica; Gibraltar; Granada; Honk Kong; the Isle of Man; Labuan; Lebanon; Liberia; Liechtenstein; Luxembourg (only with respect to holding companies regulated by Luxembourg Law of July 31, 1929); Macao; Madeira Island; Maldives; Malta; the Marshall Islands; the Mauritius Islands; Monaco; Montserrat; the Netherlands Antilles; Nauru; Nevis; Niue; Oman; Panama; Saint Lucia; Saint Vincent; the Samoa Islands; San Marino; the Seychelles; Singapore; Tonga; the Turks and Caicos Islands; United Arab Emirate; the U.S. Virgin Islands; and Vanuatu.

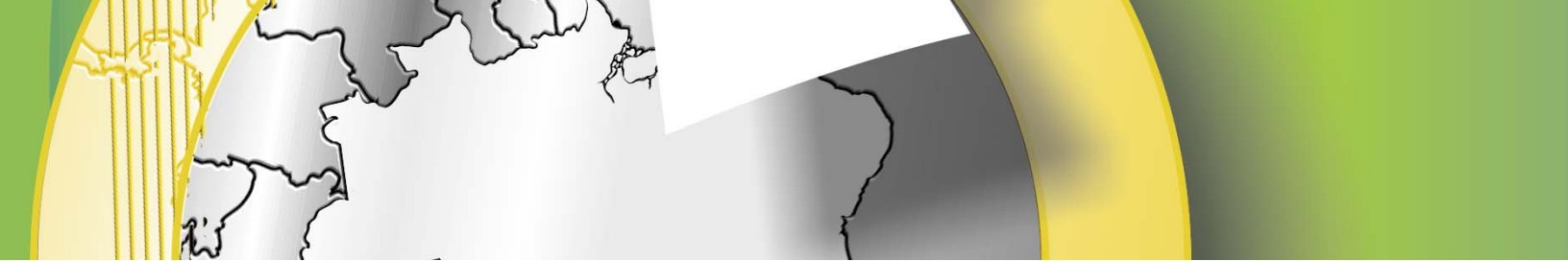
Computation methods

Different computation methods are used to determine, whether import and export transactions are being conducted in accordance with market prices, and which costs, expenses and charges are deductible for tax purposes.

There are three methods to calculate import transfer prices and four methods to calculate export transfer prices — all of them based on the Organization for Economic Co-operation and Development model and, therefore, considering (i) comparison with uncontrolled prices; (ii) resale price less mark-up; and (iii) acquisition or production cost plus mark-up. For import operations, if the effective import price is higher than the calculated transfer price, the difference will be deemed not deductible for purposes of IRPJ and CSL. For export operations, if the effective price is lower than the applicable transfer price, the difference will be considered as presumed income and included in the IRPJ and CSL calculation basis.

Tax Treaties

Brazil has entered into treaties for avoidance of double taxation with the following countries: Argentina, Austria, Belgium, Canada, Chile, China, Czech Republic, Slovakia Republic, Denmark, Ecuador, Finland,



France, Germany, Hungary, India, Italy, Japan, Korea, Luxembourg, the Netherlands, Norway, the Philippines, Portugal, Spain and Sweden.

Generally, Brazil affords its residents or citizens a credit against Brazilian income tax equivalent to the income tax paid in a foreign country, subject to the limitations of Brazilian law and strictly in accordance with the provisions of the relevant tax treaty.



Intellectual Property

The protection of intellectual property in Brazil was significantly enhanced by recent statutory reforms, including the enactment of a new intellectual property law, Law 9,279, which became effective on May 14, 1997. Law 9,279 was implemented with the objective of raising intellectual property protection in Brazil to international standards, including those enunciated in the Trade Related Aspects of Intellectual Property Rights (TRIPS) of the Uruguay Round of the General Agreement on Tariffs and Trade, the Paris Convention, the Patent Cooperation Treaty and the Berne Convention, the most important international regulatory treaties to which Brazil is a signatory. In the business community, the law heightened corporate appreciation of the importance of intellectual property issues, thus elevating investment in the area.

Patents

Under Brazilian law, inventions and utility models are patentable. To obtain a patent for an invention, the inventor must prove its novelty, industrial applicability and the inventive activity involved. Additionally, the invention must not fall into one of the categories prevented from being patented under Brazilian law, such as scientific theories, computer software, surgical techniques, and nuclear-derived compounds, among others. To obtain a patent for a utility model, the object in question or a part thereof must have a functional use and industrial application. It should also present a new shape or arrangement and must involve an inventive process resulting in a functional improvement in its use or its production.

The principle of first applicant prevails under the law. Owners of patents that have been registered in countries which are signatories to the Paris Convention may claim priority rights when applying for a patent in Brazil. The priority right term is twelve months from the filing of the first patent application. Within the priority right term other applications for the patent or its exploitation are not considered a breach of the novelty requirement.

The term of a patent is twenty years for inventions and fifteen years for utility models, as of the effective application filing date, or at least ten and seven years, respectively, as of the date of grant. Patent rights are extinguished by: (i) expiration of the term; (ii) waiver by the patent owner; (iii) forfeiture ex officio or at the request of any person with a legitimate interest, if two years after concession of the first compulsory license, abuse or non-use is not prevented or cured; (iv) failure to pay applicable annual fees; and (v) failure of a patent owner who lives abroad to appoint an attorney-in-fact in Brazil to pursue administrative acts and receive service of process. Upon extinction of patent rights, the object of such rights will be in the public domain.

During the term of the patent, the patent owner has the exclusive right to make, use or sell the patented product or process to the absolute exclusion of others. The owner may also prevent third parties from



importing products covered by the patent or products obtained directly through the patented process. A patent may be licensed or assigned by its owner for consideration or not. It is also possible to assign the title of the patent partially, but the patent itself is indivisible.

Brazilian law requires a patentee to make use of the patent or allow others to do so. A compulsory license may be applicable to owners who make use of their exclusive rights to explore the patent in an abusive manner, as well as to those who fail to make use of the patent or patented process in Brazil.

A third party with technical and financial capacity and a legitimate interest may use a patent upon request and the grant of a compulsory license over such by INPI. This applies only to patents which have not been exploited in Brazil after three years of their grant.

Patent infringement in Brazil constitutes an offense punishable by up to one year of imprisonment.

Industrial Designs

An industrial design is a new ornamental form or assembly of lines and colors of an object resulting in an original look in its external configuration, which may be applied to a product and may serve as a type of industrial production. Excluded from the legal scope of industrial designs are purely artistic works and any form or configuration that is necessarily or essentially determined by technical or functional considerations.

INPI will not consider the novelty or product applicability of an industrial design upon registration, unless specifically requested to do so by the applicant. The registration is automatically granted upon publication of the grant of an industrial design registration in the INPI's Official Gazette.

Even though Brazil is not a signatory to the Convention that establishes the International Classification of Industrial Designs, INPI resolved to adopt its terms in order to conform Brazilian proceedings to international standards.

As occurs with invention and utility model patents, the owner of an industrial design that has already been registered in a country signatory to the Paris Convention may claim priority rights when applying for registration of the same industrial design with INPI, in Brazil. The priority right's term for industrial design is six months from the first filing of an industrial design application. The registration of an industrial design lacking novelty or otherwise granted without compliance with legal requirements may be cancelled by the courts at any time during the registration term.

The term of a registered industrial design is ten years as of the date of deposit, renewable for three successive five-year terms. Industrial design rights may be licensed with or without exclusivity, and may be assigned in whole or in part.

Infringement of industrial design rights is also punishable by up to one year of imprisonment.



Trademarks

A trademark is defined by law as a visually perceptible distinctive sign which serves to identify the origin of goods, thereby avoiding confusion, deception or mistake as to origin.

Trademark rights may only be obtained through registration. Registration of a trademark may be applied for by any individual or entity, through submission of supporting documentation to INPI. Prior to the filing of an application, it is advisable to conduct a trademark search to identify any confusingly similar marks or trade names that are already in use. The registration procedure may take two years as of the application filing date.

Ownership of a trademark becomes effective upon due registration of the mark with INPI. Upon issuance of a registration certificate by INPI, the registered trademark owner has the exclusive right to use a trademark, directly or indirectly through a company controlled by it, throughout Brazil, and to assign or license its use. The registration symbol may only be used after issuance of the registration certificate by INPI and in connection with those goods and services listed in the registration certificate. A trademark owner cannot prevent accessory manufacturers from using a trademark to indicate the use of their products, provided, however, that unfair competition provisions are not infringed. It should also be noted that, despite the registration requirement, trademarks may be appropriated through use. The trademark registration term is ten years, renewable for equal and successive terms.

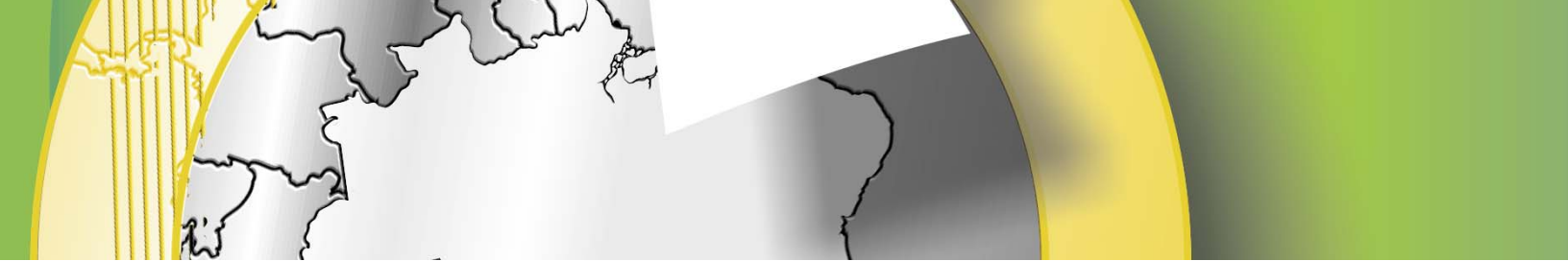
Even though Brazil is not a signatory to the Convention that establishes the International Classification of Trademarks and Service Marks, INPI adopted its terms in order to conform Brazilian proceedings to international standards.

A notorious trademark also enjoys protection under the law irrespective of prior deposit or registration in Brazil. INPI will reject any trademark application which reproduces or otherwise imitates a notorious trademark.

Owners of trademarks that have been registered in countries which are signatories to the Paris Convention may also claim priority rights when applying for a trademark in Brazil. The priority right term regarding trademarks is six months from the filing of the foreign trademark application. A proof of the prior foreign application is required in order to validate the priority right and must be presented within four months after filing the Brazilian application.

Opposition to the registration of a trademark may be submitted to INPI following the publication of the application. Trademark registration may also be subject to invalidation proceedings before Federal Courts within five years after registration.

Trademark infringement is both a criminal and a civil offense in Brazil. Anyone who, without authorization, reproduces or imitates a registered trademark so as to cause confusion or who alters a trademark already on



the market may be subject to a fine or punished by imprisonment for up to one year. Under the Brazilian Civil Procedure Code it is also possible to obtain various remedies, such as seizure, injunction and preliminary relief, from the civil courts.

Trade Secrets

Trade secrets are protected under industrial property law in provisions covering unfair competition, which impose a criminal sanction of up to one year detention or a fine for the unauthorized disclosure, exploitation or use of knowledge, information or confidential data used in industry, commerce or services. Exceptions include items of public knowledge or that are evident to a person with technical knowledge of the matter, which were accessed through a contractual or employment relationship.

Trade secret protection does not require registration and is not subject to any time limitation. The protection accorded to trade secrets will continue as long as its owner can preserve secrecy. The disadvantage of a trade secret, however, is that once it is generally publicly disclosed it will no longer be a *secret* and anyone may have access to it.

Technology Transfer and Other Agreements

In Brazil, non-patented technology or know-how is transferred and not licensed. A long-standing principle in Brazilian law with respect to unpatented technology is that the act of effecting payment for unpatented technology is equivalent to the acquisition of such technology. Therefore, recipients should always be free to continue to use transferred technology after expiration of the term of the agreement. In addition, the recipient should be free to use the technology after any applicable secrecy period has elapsed.

Trademark and patent license agreements and technology transfer and technical assistance agreements must be registered with INPI in order to be enforceable against third parties and to enjoy certain benefits such as any tax exemptions applicable to the payment of royalties.

Licensing

Registration of a license agreement with INPI is a pre-condition for the enforcement of intellectual property rights against third parties.

Licensing is the medium through which an owner allows third parties to make and sell its products and services. Licensing in Brazil may be either exclusive (when the licensee is the sole user of the rights) or non-exclusive (when the patent or trademark owner retains the right to exploit the object of the license and/or to appoint other licensees in the same territory). Licenses with Brazilian parties can be limited geographically and can also be limited in time.



Franchising

Franchise activities are governed by Law 8,955 of December 15, 1994, which defines franchising to be a system whereby a franchisor assigns to the franchisee the right to use a trademark or patent in connection with the exclusive or semi-exclusive distribution of products or services and the right to use business management or operational technology developed and held by the franchisor.

The franchisor may offer a franchise through a written franchise offering circular, which includes a history and description of the franchise, financial statements, liabilities of the franchisor and holders of relevant intellectual property rights, profile of the ideal franchisee, participation of the franchisor in franchises, investment costs, fees and rates, existing franchisees, exclusivity rules, start-up costs and supply restrictions, operational information, trademark and patent registration information, confidentiality and non-compete clauses and the standard franchise agreement, which must also be registered with INPI to attain legal effect against third parties.

Copyrights

Copyright law in Brazil protects original works of authorship, expressed by any means or fixed in any tangible medium of expression, according to Law 9,610 of February 19, 1998. Following the Berne Convention, registration of copyrights in Brazil is optional and therefore not necessary for the enforcement of rights against third parties. In fact, copyright protection arises from the creation of the work itself. The copyright system in Brazil protects both moral and economic rights. Moral rights are not transferable and cannot be assigned.

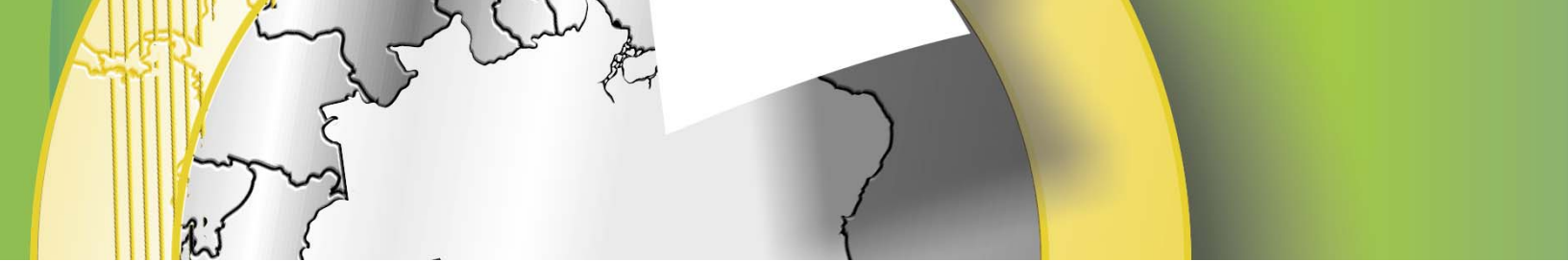
Violation of copyrights in Brazil is also subject to criminal penalties. The penalties for copyright infringement have been recently increased by Law 10,695 of August 2, 2003, which modified certain rules of the Criminal Code and the Criminal Procedure Code. It also extended criminal sanctions for violation of ancillary rights (e.g., rights of the performer, phonograph producer and broadcasting companies) and those derived from unlawful electronic distribution.

Software

Computer software is ruled by Law 9,609 of February 20, 1998. Software is considered to be a copyrightable subject matter in Brazil.

Software is protected for fifty years following its publication, release or creation. Registration is not required for the protection of software copyrights, although INPI accepts the registration of computer programs.

Technology transfer agreements involving software must be registered with INPI in order to be enforceable



against third parties. For purposes of such registration, the source code and other technical documents relating to the software are recorded confidentially with INPI.

Violation of software rights is subject to penalties ranging from monetary fines to imprisonment. A company's criminal responsibility for software infringement is attributed to its legal representatives at the time of the crime.

Domain Names

Pursuant to a delegation of powers from the Brazilian Internet Management Committee (CG), the São Paulo State Foundation for Academic Research (FAPESP) is currently empowered to register domain names in Brazil and manage the domain name system database.

The right to use a domain name in Brazil is granted to the first party that requests its registration. The Top Level Domain name used in Brazil is “.br”.

Presently, foreign companies are allowed to register domain names in Brazil upon (i) submission of a declaration of commitment to have a physical local presence and to enroll with the Corporate Taxpayer Registry (CNPJ) in Brazil within 12 months, and (ii) appointment of an attorney-in-fact in Brazil to represent the company with respect to matters concerning its domain name.

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