FOREIGN INVESTMENT IN BRAZIL

An Overview

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Over the past fifteen years

Brazil has undergone a remarkable transformation from economic isolation to global integration to become a leading emerging market. 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, after NAFTA, is arguably the most important trade agreement in the Americas. 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, mineral, 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 nature, by persons physically domiciled or resident in the country or by Brazilian public entities. Effective control was explained 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 may not 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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INDEX

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 may, in some circumstances, adversely affect the current and future activities of the foreign investor in Brazil.

In either the case of 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 may establish a Brazilian subsidiary in order to register the object products in its own name.

DISTRIBUTION ACTIVITIES[1]

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.

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; (viii) consignment terms and (ix) 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.

[1] The new Brazilian Civil Code (Law 10,406/02), which will become effective as of January 10, 2003, contains certain provisions relating to distribution activities. Therefore, the information provided in this chapter shall be reconciled with the provisions of the new Brazilian Civil Code upon its entry into force.

SALES REPRESENTATION[2]

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.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 that are acquired from and paid for to the supplier.

The relationship between the sales representative and 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 on the products, contract term, territory, commissions, payment terms, obligations and responsibilities of the parties, grant of exclusivity and termination. The supplier should also contractually reserve the right to, at its discretion, refuse purchase orders placed by the sales representative and substitute products; however, pursuant to the law, the unilateral acts of the supplier must not result in a reduction of the average commissions received by the sales representative. The agreement should also provide for compliance with applicable laws and 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 of the sales representative calculated based on 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 it until termination of the agreement. It should be noted that, pursuant to the law, the term of an agreement will be considered undetermined in any of the following cases: (i) the agreement expressly states that the term is undetermined ; (ii) the agreement does not stipulate a term; (iii) a supplier terminates an existing agreement with a sales representative and, within six months as of such termination, enters into another agreement, whether or not for a fixed term, with the same sales representative; or (iv) an agreement for a fixed term is implicitly or expressly renewed. 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 completion of the term as fixed.

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.

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[2] The new Brazilian Civil Code, which will become effective as of January 10,2003,contains certain provisions relating to sales representation. Therefore, the information provided in this chapter shall be reconciled with the provisions of the new Brazilian Civil Code upon its entry into force.

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 therewith.

Commercial laws provide for several types of company forms, of which the *Sociedade por Quotas de Responsabilidade Limitada* (*Limitada*) and the *Sociedade Anônima* (*S.A.*) are most utilized, particularly in the establishment of wholly-owned subsidiaries and formation of joint venture companies. Of the other company forms, the company branch is excessively bureaucratic to establish and the *Sociedade em Nome Coletivo* (commonly referred to as a partnership) provides for unlimited liability of its partners. Both of these company forms are infrequently used today as certain tax benefits which they historically enjoyed have been extended to other company forms.

The election of the company form most suited to the proposed activities will take into account the desired ownership structure and legal flexibility cost and confidentiality considerations, among other factors, as specific circumstances may warrant. In summary, the *Limitada* is subject to a simple regulatory framework in contrast to the *S.A*; which is governed by detailed regulations. The simplified regulatory framework of a *Limitada* allows for significant flexibility, but reduces certainty as to the treatment of different matters provided for by the law governing *S.A.s* .An *S.A.* may also be desired where ownership and management are allocated among parties with competing interests. The *Limitada* is not required to publish financial records and statements, in contrast to the *S.A* ;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. As to tax treatment, the *Limitada* and *S.A.* are accorded the same treatment under Brazilian tax legislation; however, the home tax jurisdiction of company investors may treat related *Limitada* and *S.A.* company profits and losses differently.

THE SOCIEDADE POR QUOTAS DE RESPONSABILIDADE LIMITADA[3]

The *Sociedade por Quotas de Responsabilidade Limitada* (commonly referred to as a *Limitada* and translated as a limited liability quota company), statutorily provided for in Decree 3,708 of January 10, 1919, comprised of nineteen articles, and, as appropriate, subsidiarily governed by Law 6,404 of December 12, 1976 as amended by Law 9,457 of May 5, 1997 and by Law 10,303 of October 31, 2001 (the *Corporation Law*), is often utilized in view of enhanced legal flexibility, reduced costs and greater confidentiality in comparison to the *S.A.*

[3] The new Brazilian Civil Code, which will become effective as of January 10,2003,contains various provisions regulating companies organized as Limitadas. Therefore, the information provided in this chapter shall be reconciled with the provisions of the new Brazilian Civil Code upon its entry into force.

Legal Nature

A *Limitada* is a relationship of a contractual nature which subsists between two or more competent individuals or legal entities or any combination thereof, known as partners, also referred to as quotaholders, to carry on commercial and/or service activities. Each partner of a *Limitada* has limited liability up to the full amount of the total subscribed capital until fully paid and, thereafter, to the amount of its respective contribution. Pursuant to applicable legislation, the *Limitada* accords the majority partner broad decision-making power unless otherwise provided for in corporate documents, without prejudice to certain rights of dissent.

Formation

The partners, whether or not resident Brazilians, may constitute a *Limitada* by signing a *contrato social* (articles of association) and complying with registration requirements of the state in which the head office of the company is to be located. As 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. As to the number of partners, unless otherwise provided for in the articles of association, a *Limitada* is dissolved if left with fewer than two partners, including by death of an individual partner. Therefore, as a matter of precaution, where only one partner is a legal entity, there should be at least two individual partners. A partner who is not a resident Brazilian must be represented in its capacity as partner by a resident Brazilian, pursuant to an annual power-of-attorney, notarized and consularized by the Brazilian Consulate of the non-resident partner's country of origin and officially translated and registered in Brazil.

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 set out: (i) the name of the partners and respective personal data, (ii) the name of the *Limitada*, which must include the expression *"Limitada "* and may not be identical or similar to the name of a pre-existing company, (iii) the corporate purposes, (iv) the company duration, which may be determined or undetermined, (v) the company capital and whether or not it is fully-paid and payment term, which if silent requires payment to be effected within ten days of subscription, (vi) each partner's capital contribution therein and that the responsibility of each partner is limited to the company's subscribed capital, and (vii) other necessary clauses to determine the rights and obligations between the partners and between partners and third parties. The articles of association should identify the managing partner; otherwise all partners will be managers. In addition to the articles of association, the relationship between the partners may be governed by a separate agreement, subject to specific performance pursuant to the *Civil Procedure Code* .

Depending on whether the *Limitada* is commercial or civil (activities restricted to services), the partners must register the articles of association with the competent state commercial registry or registry of deeds and documents, respectively. The articles of association of a commercial *Limitada* must be registered within thirty days of execution, in order to have legal effect retroactive as of the date of execution between the partners and against third parties. In the case of a civil *Limitada*, the articles of association are effective between the partners and against third par ties as of the date of registration. In the State of São Paulo, a commercial *Limitada* registration costs approximately US$950*and is processed in five business days and a civil *Limitada* registration costs approximate US$700*and is processed in three business days. Registration also provides limited trade name protection of the company name identified in the articles of association; however, enhanced trade name protection results from the registration of

the company with the competent registry of each Brazilian state and the registration of the company trademark with INPI. It should also be noted that although corporate documents of the *Limitada* are not required to be published, registered documents are made publicly available. In addition to company registration, commercial and civil *Limitadas* must also be registered with the federal tax authorities (the National Legal Entity Registry of the Federal Revenue Department (CNPJ)), which may take up to thirty days to process.

Capital

The capital of the *Limitada* is typically divided into one class of units called quotas, although it may be divided into two or more classes of units, such as voting and non-voting quotas. 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. Quotas are not represented by physical certificates and may not be publicly traded. No minimum capital requirements exist. 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 on its turn triggers minimum capital requirements as explained below.

As a requirement for the approval of a permanent visa application on behalf of a nonresident individual manager, the company must provide evidence that the foreign investor has made a minimum capital investment in the company of US$200,000*, except where the nonresident is from a Mercosul member country, in which case the minimum capital investment requirement is US$100,000*. For the purposes of this requirement, investment may be made in the form of currency, capital goods, technology transfers or payroll increases, as provided by law. Evidence of this investment must be provided with (i) the applicable amendment to the articles of association in which the investment was recorded and (ii) either a document from the Central Bank of Brazil (BACEN) evidencing registration of the foreign investment or a copy of the foreign exchange contract evidencing the inflow of funds and an independent public accountant certification that the investment was made in the relevant company.

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 an amount mutually accepted by the partners, which nevertheless shall be liable for overvaluations. A partner who fails to fully pay-up quotas subscribed for by it on the terms provided in the articles of association may be removed from the *Limitada* by the other partners.

Profit distributions may be effected at the discretion of the partners and/or may be specifically provided for in the articles of association, both as to time and amount. Unless otherwise provided in the articles of association, applicable legislation does not require profit distributions to partners to be effected in proportion to their respective quota interest. However, this flexibility does not benefit partners seeking to effect foreign remittances of profit distributions. As discussed below, the interest of a foreign investor in a company is recorded in a foreign investment registration with BACEN. A foreign investment registration, according to applicable regulations, entitles the partner holding title thereof 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 or, where such are silent, subject to applicable statutory provisions. A *Limitada* may redeem issued quotas, provided that such quotas are acquired with available funds and without prejudice to the capital. Changes in capital ownership and levels are effected by an amendment to the articles of association registered with the competent state registry. Furthermore, quotas may generally be the object of pledges and other encumbrances.

Rights and Obligations of Partners

An important feature of the *Limitada* is the co-existence of the principle of majority rule and dissent rights. Pursuant to legislation, all business matters, including the appointment and dismissal of partner-managers, may be decided upon by the partner or partners holding a majority of the capital, subject to the articles of association. A partner who dissents to an amendment to the articles of association is entitled to withdraw from the *Limitada*, receiving the amount corresponding to its capital contribution verified in the last financial statements. The specific manner in which reimbursement is to be calculated may be governed by the articles of association.

Each partner of a *Limitada* is, as a partner, liable for the acts, obligations or liabilities of the *Limitada* up to the full amount of the company's capital until fully-paid and thereafter to the amount of its individual capital contribution. 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 and where the partners do not include the expression *"Limitada "* in the company name or fail to register the articles of association and other corporate documents subject to registration with the competent registry. In addition to the liability provided for in the legislation specifically governing the *Limitada*, a partner may also be criminally liable for the improper use or abuse of the company.

Management

Management of the *Limitada* may be vested in one or more resident or nonresident partners, individuals or legal entities. Where more than one partner is empowered to manage the company, the articles of association may specifically define the management power of each partner and whether or not they may act independently or must act jointly in all or certain business matters. In the absence of express provisions governing management powers, all partners are presumed to be able to act on behalf of the company independently.

When the partners, whether legal entities or individuals, are not resident in Brazil, delegate-managers must be empowered in the articles of association or in their respective instrument of appointment to exercise all activities related to the corporate purpose of the *Limitada*, subject to specific limits and/or restrictions. Non-resident partners should reasonably limit the powers of delegate-managers and require delegate-managers to obtain their prior approval for the performance of certain acts to safeguard their interests. Regardless of the provisions of the articles of association and/or instruments of appointment, neither a partner nor a delegate-manager may perform activities alien to the specified corporate purposes, nor use company funds, assets and/or possessions for its own benefit or that of third parties without the prior written unanimous consent of all partners.

The *Limitada* is liable for all acts performed on its behalf by delegate-managers acting within the scope of their powers. Similarly, delegate-managers are not personally responsible for the obligations contracted on behalf of the *Limitada*, but are liable to the *Limitada* and third parties, including government authorities, for acts outside the scope of their mandate or in violation of the articles of association or the law and may consequently be removed from the *Limitada* .

The legislation applicable to the *Limitada* does not establish mandatory administrative mechanisms for the exercise of managerial powers, such as meetings, management bodies such as a *board of directors* or audit committees. General business matters are usually resolved by delegate-managers, pursuant to the articles of association, and any and all amendments to the articles of association may be effected by majority partner approval, unless otherwise indicated in the articles of association, which grants the *Limitada* considerable decision-making flexibility. Also, although the articles of association and amendments thereto must be registered with the competent state commercial or civil registry, they need not, as is also the case with financial records and statements, be recorded in separate corporate books or published, which results in cost savings and confidentiality benefits for the *Limitada* .

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 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 the expression "*Companhia*" or "*Sociedade Anônima*" (or abbreviated "*S.A.*") and may not 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 Brazilians. 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-up in cash in 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 shareholder 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, Minutes and Opinions of the Audit Committee. The *S.A.* must also be registered with the CNPJ.

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 depository 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-up in cash or assets of a value determined by expert appraisal and approved by the shareholders.

The shares of the *S.A.* may be classified 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.s.* incorporated after October 31, 2001 (date of approval of major revision of the Corporation Law), the number of non-voting or restricted voting preferred shares may not exceed 50 percent of the total number of issued shares. The same limit of fifty percent should 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 the ratio between preferred shares with non-voting rights or restricted voting rights and voting shares up to a limit of two-thirds of the total number of issued shares.

Shares of publicly-held *S.A.s.* may only be traded after 30 percent of the issue price is paid-up. Shares of a privately-held *S.A.* may not 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 over the shares must be recorded in the relevant share registry book or with the depository 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 securitites, 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 to 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, may have multiple series, and their creation is subject to shareholder approval granted at a general shareholders meeting. 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 publicly traded must be represented by an *agente fiduciário* (trustee), whose duties are set forth in the debenture indenture.

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.

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. Shareholders must always be entitled to participate in company's profits and proceeds of dissolution, to inspect the business of the company, to enjoy pre-emptive rights in the subscription of new shares and other securities that are convertible into shares, and to enjoy dissent and withdrawal rights as provided by law. 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 is reflected in relevant company registries.

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 maintain a representative in Brazil empowered to receive service of process, through which its rights are exercised.

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, however, will acquire voting rights where the company fails to pay fixed or minimum dividends to which the preferred shareholders may be entitled 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 following the end of the fiscal year to consider and review financial statements, to decide upon the use of profits and distribution of dividends and to elect managers and members of the audit committee, 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 ordinary general shareholders meetings, such as amendments to the by-laws, which may also be subject to the approval of preferred shareholders as per the by-laws, removal of managers and members of the audit committee, issuance of debentures, suspension of voting rights, appraisal of assets contributed to pay-in capital subscribed for, and transformation, merger, incorporation, spin-off, dissolution, liquidation 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 shareholder 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 or consolidated with another company or comes to participate in a group of companies. The calculation of the value of the shares may be governed 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 that shall be specified in the by-laws, subject only to the existence of sufficient profits in the respective 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) the formation of a legal reserve, and (ii) the formation of a contingency reserve and reversal of contingency reserves of previous fiscal years, provided that payment of such dividend may be limited to the amount of realized profits of 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.

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 on such dividends up to an amount 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 profit, up to a limited amount. However, privately-held *S.A.*s which are not controlled by a publicly-held *S.A.*, as well as publicly-held *S.A.s* which only raise 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.

The liability of shareholders is limited to the issue price of subscribed or acquired shares, with limited exceptions, which must be paid in accordance with the by-laws or subscription agreement. If a shareholder should fail to make such payment, the company may initiate an action to collect amounts owed or order the sale of shares. The shareholders are also obligated to exercise voting rights in the best interests of the company and 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 and meet.

Management

Management of a company is vested with a *conselho de administração* (board of directors) and a *diretoria* (directorate). The board of directors (optional in the case of a privately-held *S.A.*, provided that its by-laws do not specify an authorized capital level), whose functions resemble those of a U.S. board of directors, must be comprised of at least three individual shareholders resident in Brazil or non-resident (provided that the latter are represented in Brazil by (an) attorney-in-fact(s)). They are elected at a general shareholders meeting and are known as *conselheiros* (members of the board of directors). The board of directors is mandated to direct the company´s business; elect and remove and establish the duties and responsibilities of the company's officers; inspect the activities of officers and company records and documents, including those with third parties; 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 share issues or dividends; 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, audited in the case of a publicly-held *S.A.*, approved by the shareholders and published, although certain exceptions are available for privately-held *S.A.s* with less than twenty shareholders and a net capital of less than one million Reais.

The directorate must include at least two individuals resident in Brazil, who may or may not be shareholders and must be elected by the board of directors, if one exists, or otherwise at a general shareholders meeting. Such members are known as *diretores* (officers). Up to one-third of the members of the board of directors may also serve as members of the directorate. The duties of the officers may be established by the board of directors or in the by-laws, which if silent, entitle any officer 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 conduct 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 within the scope of their powers but with negligence.

Audit Committee

The by-laws of a company must indicate whether an audit committee shall exist on a permanent basis or if it shall become operational upon shareholder request. The members of the audit committee, comprised of three to five individual resident Brazilians, who need not be shareholders, are elected at a general shareholders meeting. The responsibilities of the audit committee, which may be specifically provided for in the by-laws, include the duty to: (i) inspect the acts of management to ensure compliance with the law and by-laws, (ii) comment on the annual management report and proposals to be submitted to general shareholders meetings, (iii) denounce to the directorate or 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) exercise certain acts during liquidation.

Other Provisions

The Brazilian Corporation Law also permits the creation of other corporate bodies, in addition to those mentioned above, as may be provided for in the by-laws, whose members are liable on the same grounds as members of the other corporate bodies. The 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 in control, corporate groups and consortia.

Liquidation of Financial Institutions (Personal Liability of Controlling Shareholders, Directors and Officers)

The Brazilian Law on Intervention and Extrajudicial Liquidation of Financial Institutions, Law 6,024 passed on March 13, 1974, sets forth in considerable detail the consequences of a financial institution showing signs of weakness or imminent failure. It gives the Central Bank of Brazil ("BACEN") broad powers to fashion remedies, including the power to freeze substantially all of the personal assets of the directors and officers of the failing institution while investigating the causes of failure.

In the event that an institution meets certain criteria indicating financial peril, the statute permits BACEN to either *intervene* and essentially take over the operation of the institution, or *liquidate* it. In addition, BACEN has authority to impose, in circumstances which did not warrant intervention or liquidation, a *special temporary administration* within a troubled financial institution. In such case, directors and officers are jointly liable with the controlling shareholders of the financial institution for all obligations of the institution. The law also provides that in certain circumstances the institution may be placed in the hands of the bankruptcy courts. As a practical matter, however, troubled financial institutions in Brazil are typically managed outside the bankruptcy court system, or *extrajudicially*, by BACEN.

BACEN may *intervene* in a troubled financial institution in the following three circumstances:(i) the entity suffers losses which arise from poor management and which subject its creditors to risk; (ii) BACEN determines that there are verified and repeated infractions of banking laws which continue to be unresolved; or (iii) the entity becomes insolvent or bankrupt pursuant to bankruptcy legislation.

Extrajudicial liquidation, on the other hand, may be ordered by BACEN whenever: (i) the institution's financial health is threatened, especially when it fails to timely meet its commitments, or reasons exist which would authorize the declaration of bankruptcy; (ii) management commits *serious* violations of governing law, including the rules of BACEN or the National Monetary Council (CMN); (iii) the institution suffers losses which subject its unsecured creditors to abnormal risk; (iv) within ninety days following the revocation of its authority to operate, the institution fails to begin its ordinary liquidation; or, having begun the ordinary liquidation, management's laxity in completing it threatens the institution's creditors with losses;(v) upon the request of management (if the company's by-laws so permit) or of the intervenor (where BACEN has already initiated an intervention), if justified.

Even where one of the above circumstances justifying liquidation exists, BACEN has the discretion to order intervention instead. Intervention may be ordered if it is adequate to normalize operations of the institution and liquidation would have an adverse effect on financial markets.

In the event that a financial institution is placed under intervention, or in liquidation or bankruptcy, all of the assets belonging to the controlling shareholders, directors and officers of those institutions will be frozen. Specifically, *all assets* will be *unavailable*, and may not be sold or encumbered, in any form, directly or indirectly, until the final resolution of their (the controlling shareholders', directors' and officers') liabilities.

The asset freeze arises when the decree of intervention, liquidation or bankruptcy is issued, and applies to any individual who acted as an officer or director in the twelve months prior to issuance of that decree. In addition, individuals whose assets have been frozen may not leave the venue of the intervention, liquidation or bankruptcy proceeding without the prior, express permission of BACEN or the bankruptcy judge.

BACEN may also, with the approval of the CMN, extend the asset freeze beyond the shareholders, officers and directors. The extension may cover the assets of *managers, tax advisors and all those who, up to the limit of estimated liability of each, were involved (in the management of the institution) in the twelve months prior to the declaration of intervention or extrajudicial liquidation* .The extension may cover the assets of persons who acquired property

in the twelve months prior to liquidation/intervention from any of the foregoing individuals, or from an officer or director, where circumstances suggest that the property was transferred in order to avoid the effects of Law 6,024 .

The statute excludes certain limited categories of property from the asset freeze. In addition, the law exempts assets that are under a contract of sale, the subject of a purchase/sale agreement or under assignment or promise of assignment. This exception only applies, however, where the respective written instruments have been publicly recorded prior to issuance of the decree of intervention, liquidation or bankruptcy.

Immediately following the declaration of intervention, liquidation or bankruptcy, BACEN is required to undertake an investigation into the causes of the institution's troubles and the extent of management's responsibility for any losses. BACEN must issue a report within one hundred twenty days (with an additional one-hundred twenty day extension possible). If the report concludes that there were *losses*, then the assets of the controlling shareholders, directors, officers, *et.al.* not previously frozen will be seized, in an amount sufficient to satisfy their liability.

Subsequent to the issuance of the BACEN report, however, the actual liability of the controlling shareholders and managers of the financial institution will be determined in a civil court (in the case of intervention/liquidation) or bankruptcy trial. In the case of intervention/liquidation, either the government or a creditor may file suit to initiate this process. Upon entry of a final judgment against a controlling shareholder, director, officer, etc., the asset freeze/seizure will be converted into a judicial lien, subject to execution.

Law 6,024 also permits BACEN to extend that law's regulatory scheme to individuals or directors, officers, etc. of institutions that are *related* to troubled financial institutions. Related entities or individuals include debtors of the troubled financial institution, significant equity-holders (more than 10 percent), as well as spouses, blood relatives and in-laws of key personnel. Amendments in 1997 to Law 6,024 also broadened the BACEN's power to freeze assets to include the assets of those entities with *control, direct or indirect*, over the troubled institution.

JOINT VENTURES AND MERGERS AND ACQUISITIONS

The selection of joint ventures and mergers and acquisitions as alternatives to the exercise of investment activities through a 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 activities of the target company, particularly tax and labor.

JOINT VENTURES

Joint ventures are structured through the establishment of a company, taking the form of a *Limitada* or privately-held S.A, the selection of which should consider contemplated activities, ownership and management structure and confidentiality concerns, among others. In the establishment of a joint venture, the principal negotiation issues are generally the purchase terms and conditions, object activities, ownership and management structure, know-how and technology transfers, representations and warranties, indemnification, guarantees, confidentiality, non-compete, dispute resolution and termination. The preliminary understandings of the parties on these and other issues may be recorded in a *pré-contrato* (memorandum of understanding), which provides for further exclusive negotiations and due diligence investigations, discussed below. A memorandum of understanding is binding on the parties, unless the contrary results from the terms of the memorandum, nature of the business or circumstances of the case.

Upon the successful completion of negotiations, the joint venture company is created (as described above in section *Establishment of a Brazilian Subsidiary*), as the case may be, and concurrent therewith a joint venture agreement is executed between the parties. The articles of association or by-laws of the joint venture company may merely satisfy legal requirements, with the specific terms and conditions of the joint venture provided for in a separate joint venture agreement. The joint venture agreement, unlike the articles of association or by-laws, is not required to be registered and may be kept confidential.

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 Brazilian courts 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 discussed below. As a preliminary, although important, discussion point, the parties to the transaction should consider whether or not to effect it through an asset or share acquisition, at which time it should be noted that the outcome of due diligence investigations, particularly tax, 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 upon the approval, execution 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 the execution of the 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 delegate-managers.

Acquisition of an S.A.

The acquisition of a privately-held *S.A.* is effected upon 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 respective 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 offeror a controlling interest. The offering circular executed between the offeror and the financial institution must be published and stipulate the minimum or maximum number of shares subject to the offer, price and payment terms, as well as information about the offeror. As detailed in the offering circular, an offer requires the

acceptance of a minimum number of shareholders and must be open for no less than twenty days, and must be communicated to the CVM within twenty four hours of publication.

The offeror may increase the price and/or improve the payment terms and conditions offered only one time, provided that such increase or improvement must result in an amount equal to or greater than five percent and that it is effected no later than ten days prior to the end of the offering period. The new price and/or payment terms and conditions will be extended to the shareholders that have already accepted the offer.

The existence of a public offer in progress does not preclude a competing offer. The publication of a competing offer nullifies the sale orders already signed in acceptance to the previous offer. The original offeror may postpone the time period of its offer to make it coincide with that of the competing offer.

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

At the planning stage, all parties to be involved in the proposed transaction should be identified, including corporate representatives, foreign and/or local internal and/or external counsel, investment banks and accounting firms. The purpose of due diligence investigations in Brazil, as elsewhere, is to allow the prospective purchaser to better assess the value of proposed transactions and identify related contingencies, even though the scope of such investigations may vary on a case by case basis. At this initial stage, the scope of and schedule for due diligence investigations should be clearly defined, including the form of the report, and the assembly of all documents and information to be reviewed should be coordinated. Progress meetings should be scheduled throughout the due diligence process and on an as needed basis.

Corporate

Corporate documents, and any amendments thereto, of the target company may be obtained from the competent registries, including state commercial registries, the securities commission and public notary offices, or, along with other private documents, from the target company itself. Documents are reviewed to confirm equity interests and title thereto, transfer restrictions and procedures, rights of first refusal and encumbrances. Corporate documents to be reviewed,

depending on the legal form of the target company, include the articles of association, quotaholders agreement, if any, minutes of quotaholders meetings, by-laws, shareholders agreement, if any, and required registry books, including the minutes of shareholders meetings and those of management bodies. In addition to these documents, any other documents related to the object equity interest, including dividend records, are reviewed.

Government registrations, including federal, state and municipal tax registrations and other activity and/or product specific authorizations and regulatory requirements are also reviewed. As are any identified government grants, subsidies, incentives and other financing arrangements, including those provided by the National Economic and Social Development Bank (BNDES) and the Government Agency for Machinery and Equipment Financing (FINAME). Also, where the seller is a nonresident, it should hold a foreign investor registration corresponding to its equity interest in the target company, which should be examined to ensure that it accurately reflects the seller's equity interest therein.

Tax

Tax, along with labor and employment, discussed below, are the primary due diligence concerns in the case of quota/share and asset purchases in view of the significant outstanding amounts often involved and also, in the case of asset purchases, succession concerns. Legal due diligence commences with the acquisition of tax status reports on the target company with the competent federal, state and municipal tax registries. The status reports are thoroughly reviewed and further searches and inquiries are made on each reported item. Outstanding taxes may be the object of tax disputes, which are commonplace, generally due to the complexity of the tax system and, more recently, to successful constitutional challenges to recent amendments to tax and social security laws. Furthermore, the existence of tax debt re-negotiation plans between the company and tax authorities is also confirmed and reviewed.

Audit due diligence work by an accounting firm is conducted concurrently with legal due diligence to determine whether or not the company has accurately accounted for and reported taxable activities and paid or withheld applicable taxes and contributions. The results of the audit and legal due diligence are examined to assess the overall tax risks of the joint venture or acquisition.

In the case of asset purchases, where tax risks are significant, succession becomes a key 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 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 object of the acquisition, or secondarily liable where the seller continues to exercise the activities 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 object of the acquisition.

The statute of limitation for tax matters is five years as of the first day of the calendar year following the year in which the tax was first assessable. During this period, tax risks may be

mitigated by the inclusion of broad contractual representations and warranties in favor of the purchaser, escrow arrangements, holdbacks and staggered purchase price installments.

Labor and Employment

Labor and employment, as with tax, is a primary due diligence concern. Legal due diligence commences with a thorough review of the labor and employment records of the target company, particularly the registration of employees and payment of legal dues. 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 legal determination of whether or not an employment relationship exists. Contracts with service providers, including distributors and commercial representatives, are also reviewed to determine whether or not such relationships have been properly documented and to verify associated labor risks. Status reports on outstanding labor claims and proceedings against the company are also obtained from the competent labor tribunals and courts, which are thoroughly reviewed with company records. Workplace health and safety due diligence may also be conducted. During the course of due diligence, an assessment may also be made of the costs associated with post-completion downsizing. It should also be noted that neither joint ventures nor acquisitions require prior employee approval. In the case of joint ventures, due diligence should also consider the corporate interests of the partners or shareholders of the target company, other than those held in the target company, as labor authorities may characterize 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.

In addition to legal due diligence, audit due diligence work by an accounting firm is also conducted to determine whether or not the company has accurately accounted for and paid or withheld applicable labor and employment dues and contributions. In normal circumstances, employee dues and contributions equal approximately to 100 percent of salary pay. Employment dues and contributions include contributions to the National Institute for Social Security (INSS) and Time-of-Service Guarantee Fund (FGTS), often characterized as a severance fund. FGTS contributions are made in respect of each employee and may be accessed by the employee in specific circumstances, including dismissal without just cause and retirement. In addition to these statutorily required benefits, the target company may or may not offer private pension or retirement benefits. The results of the audit and legal due diligence are examined to assess the overall labor risks of the joint venture or acquisition.

Where labor and employment risks are significant in the case of a quota or share purchase, joint liability is a concern. The Brazilian Consolidation of Labor Laws (CLT) provides that a change in the legal structure of a company will not affect the labor rights of employees. Therefore, employees may successfully institute labor claims against the joint venture partner or purchaser of the target company related to their pre-completion employment term. In the case of an asset purchase, succession is also a concern where the purchaser contracts employees formerly employed by the seller of the assets acquired.

The statute of limitation for employment matters is five years; however, upon the termination of an employment contract, any and all actions in reference to the previous five years must be initiated within two years of the contract's termination. However, civil actions may also be instituted in labor and employment matters relating to workplace accidents and illnesses, in which case the statute of limitation is twenty years. Assessed risks may generally be mitigated by contractual representations and warranties, or alternatively by the termination of all

employees of the target company at completion and subsequent re-employment of some or all of the same employees to continue in the employment of the target company after completion.

Contracts

Contracts are reviewed generally to analyze the corporate and finance structure of the target company's activities. Specific contract provisions are reviewed to consider any change in control provisions, including termination and acceleration of term, client supply, financing and mortgage agreements and other agreements evidencing the encumbrance of assets of the target company. Furthermore, any confidentiality and/or non-compete provisions are reviewed to identify any restrictions applicable to the prospective purchaser. It should be noted that Brazilian law does not provide for succession of contracts, referred to as *commercial succession*, in the case of an asset purchase.

Real Property

Real property due diligence starts with the identification of all real property owned, in the state of emphyteusis, leased or otherwise used in corporate activities. The terms and conditions underlying the ownership and/or use of such property are reviewed according to the status of the property as urban or rural. Title searches are conducted on the subject real property of the target company with the competent local Real Estate Registry Office (RI). The analysis of updated certificates issued by the competent RI will extend to real estate records covering the twenty years preceding the search date, which period corresponds to the twenty year property rights statute of limitation under Brazilian law. This analysis will ascertain the current status of the real estate as well as the existence of any burdens, liens or other encumbrances. Easements over the subject real property, if any, are also reviewed.

Where any constructions have been built on the real property, the records of each construction with the relevant municipality and RI are reviewed to ensure that the records are consistent with each other and accurately reflect the construction.

The use of the subject real property and activities conducted thereon are also reviewed to check for compliance with applicable zoning rules. Accordingly, the current year's Urban Building and Land Tax (IPTU) payment booklet related to real estate and applicable licenses is reviewed. The failure to comply with zoning rules may result in the imposition of fines, suspension of activities and/or demolition of the construction built on the subject real property.

Other possible contingencies related to the subject real property and/or constructions thereon are also reviewed, including any outstanding INSS debts owed in relation to constructions.

The terms and conditions of any lease agreements are also reviewed. The key terms and conditions reviewed, where provided for in the agreement, are: (i) the term, including renewal and termination; where the term is a minimum of five years, under certain conditions the lessee will be entitled by law to a five year renewal; (ii) the permitted use of the leased premises; (iii) the state of the leased premises at delivery and on return; (iv) restrictions on the change in name of the establishment object of the lease; (v) improvements; (vi) transfer fee, if applicable; (vii) change in control of the lessee; (viii) lessor's prior authorization for the assignment and transfer of the lease; and (ix) fixed and variable lease/rental payments. The certificate evidencing the

subject leased premises recorded with the RI is reviewed and the lease agreement itself must be registered with the RI to be effective against third par ties. Furthermore, any general rules applicable to the leased premises, such as those imposed by a shopping mall to premises located within the mall, are also reviewed.

Intellectual Property

Intellectual property, including trademarks and patents, owned, licensed or otherwise used in corporate activities and corresponding agreements, if any, and registrations with INPI are reviewed to confirm that the target company is legally entitled to use relevant intellectual property and that relevant intellectual property rights may also be used in the activities of the joint venture or in the case of an acquisition, are transferable to the purchaser. Technology transfer agreements between a nonresident licensor and the target company are also reviewed and registration thereof with BACEN is confirmed. Such registration is required to effect foreign remittances of royalty payments at the commercial exchange rate and enables certain deductions of royalty payments for tax purposes. In addition to the above, copyrights, trade secrets and software used in the target company's activities are reviewed to confirm ownership or rights to use and assign such.

The globalization of the economy has brought about an enlargement in the amount of business done through the Internet. There are a number of Intellectual Property matters related to so-called e-business that should be considered. The web sites should be analyzed in order to assure that the advertising procedures comply with the Brazilian Consumer Code, that copyrights are being observed and that no image rights are being infringed.

Litigation

Litigation, outstanding or threatened, involving the target company, is assessed and potential liabilities are quantified. Report on litigation matters contains a description of the lawsuits in which the company is involved or threatened to be involved, and potential liabilities, as well as possible outcomes of the cases are assessed and calculated. Associated risks are generally mitigated with contractual representations and warranties and indemnification provisions.

Environment

Environmental due diligence confirms that the target company possesses all required operating licenses and permits and that its activities are conducted in compliance with such environmental regulations generally applicable. 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 damages 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 remedies.

Other

The following issues may also be relevant to consider, depending on the circumstances of the specific case. No stamp duties are payable in Brazil. In the case of joint ventures, as part of the due diligence process, it may be possible to obtain information on the financial history of the partners or shareholders of the target company to assess the impact of any debtors thereof seeking recourse against equity interests in the joint venture company, which may adversely affect the conduct of business activities. Estate issues may also be considered in the formation of a company and are relevant in the case of individual partners to a joint venture, for upon the death of an individual partner, family heirs may be entitled to participate in the estate of the deceased, which may not be denied by will.

ANTITRUST PROVISIONS

Although competition legislation has existed in Brazil since 1962,actual antitrust enforcement only started in 1994, with the publication of Law 8,884 (Competition Law). The Competition Law also provided for the transformation of the existing regulatory authority into an independent antitrust agency, the Administrative Council for Economic Defense (CADE).

The Competition Law is a complex act with 93 sections dealing with both conduct and review of mergers. Although it follows closely the U.S. competition law model, it does not impose a bar on closing, generally allowing the parties the choice to consummate the deal before a final decision is rendered, at their own risk.

CADE has enacted several Resolutions aimed at regulating certain areas not provided for by the Competition Law or to clarify procedural aspects of antitrust enforcement. The main ones refer to guidelines for merger review and to CADE's internal by-laws. The two other governmental agencies Secretariat of Economic Law of the Ministry of Justice (SDE) and Secretariat of Economic Affairs of the Ministry of Finance (SEAE) that assist CADE to investigate cases have also enacted rules and regulations governing the enforcement of antitrust legislation.

Mergers and Acquisitions

The Competition Law sets out the actions that must be submitted to CADE for its review. Any acts, however arising, which may (i) restrain or in any way adversely affect free competition or (ii) result in domination of a relevant market for goods or services, must be notified. Notification is also mandatory for acts involving any type of economic concentration whether by means of a merger or consolidation, formation of parent company or any other business combination which result in a company or group of companies holding a 20 percent share in a relevant market, or if it includes a participant (including the group to which the relevant company belongs) which has recorded in its latest balance sheet worldwide annual gross sales equal to or in excess of R$400million*.

Brazilian legislation does not consider a high degree of market share as breach of the antitrust laws per se. CADE will always take into consideration the trade-off between reducing competition and enhancing efficiency. In fact, the Competition Law expressly determines that

even those acts that may limit competition or result in market domination may be approved by the CADE, provided they comply with the following conditions:

(i) they have one or more of the following purposes:
   a. to increase productivity;
   b. to improve the quality of a product or service; or
   c. to cause increased efficiency, as well as foster technological or economic development.
(ii) the resulting benefits may be allocated pro-rata to the parties and to the consumers and or end-users;
(iii) they will not drive competition out of a substantial portion of the relevant market for a product or service; and
(iv) they are restricted to attaining the envisaged objective.

Thresholds

A resulting market share of 20 percent in a relevant market triggers the need to notify irrespective of the turnover of the parties or the value of the transaction. However, if any one of the parties has worldwide turnover in excess of R$400 million*, such fact will also trigger the notification requirement.

Penalties

Although the Competition Law allows penalties to be imposed, CADE was initially reluctant to impose fines due to the lack of a competitive environment in Brazil. Soon, however, it became clear that Brazilian companies and the market as a whole had all had adequate education on antitrust matters, and they should therefore start facing the imposition of fines provided in the legislation. The vast majority of pecuniary penalties imposed to date have arisen because parties have failed to notify a transaction or have taken too long to do so. This has become more prevalent after case law developed considering the first document signed by the parties as the triggering moment for notification. Fines may range from approximately US$30,000*to US$3 million*, depending on several issues, including the size of the breach, its repetition, and even the economic power of the party being penalized.

FOREIGN CAPITAL REGISTRATION

The registration of foreign capital with BACEN, is provided for by Law 4,131 of September 3,1962 and Law 4,390 of August 29,1964 and is regulated by Decree 55,762 of February 17,1965 as amended, 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,enacted on 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 CMN, 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, effective as of March 1, 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 before the inflow of the corresponding funds into Brazil. The borrower and the issuer of securities are allowed to appoint a representative to handle such registration. 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 of payments of principal, interest, fees and commissions abroad.

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, 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) imposed at the rates of 25[4] percent and 9 percent respectively.

Companies are required to file an annual federal tax return for each calendar year (January 1st - December 31st), 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 respective transaction.

Taxes on Revenues

Domestic companies must also pay to the federal government the Social Contribution for the Financing of the 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 obtained 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. COFINS and PIS are imposed at the rates of 3 percent and 0.65 percent.

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 Local Service Tax (ISS). Import and export transactions are subject to the Federal Import Tax (II), the Federal Export Tax (IE),

[4] Basic rate of 15 percent, plus an additional rate of 10 percent on the taxable income that exceeds R$240,000*per year, or R$60,000*per quarter, or R$20,000*per month.

IPI and ICMS. Their rates may vary according to the respective product or service, 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.

IOF is levied as follows:

(i) *IOF/Credit* on any credit transaction carried out in Brazil, calculated according to the maturity term of such credit transaction, at a rate of 0.0041 percent per day, up to 1.5 percent per year. In many cases, such IOF/Credit is reduced to zero and, therefore, a case by case analysis is required. The lender is responsible for withholding and collecting this tax.

(ii) *IOF/Bonds and Securities* on any transactions involving bonds and securities, even in the case of transactions carried out within a Brazilian exchange.

(iii) *IOF/Insurance* on the premium paid to acquire insurance, generally charged at a rate of 7 percent, except for health insurance, in which case the rate is reduced to 2 percent. The insurance company is responsible for withholding and collecting this tax.

(iv) *IOF/Foreign Exchange* on any conversion of foreign currency into Reais, as well as any conversion of Reais into foreign currency. Currently, except for certain limited situations, the applicable rates have been reduced to zero, although the Minister of Finance may raise such rates at any time, up to a maximum of 25 percent. The intermediary bank for the currency exchange operation is responsible for withholding and collecting this tax.

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 otherwise provided by specific rules. Capital gains realized outside Brazil in transactions involving non-Brazilian parties are not subject to Brazilian income tax.

Dividends

Dividends payable by a Brazilian company to a Brazilian resident or non-Brazilian resident shareholder 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 non-Brazilian resident with respect to loan transactions are subject to withholding income 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 for in an applicable tax treaty between Brazil and such other country where the beneficiary of the payment is domiciled. Taking into account all the tax treaties signed by Brazil, only remittances of interest to Japan are currently benefited with a lower 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 withholding income tax at the rate of 15[5] percent, or such other lower rate as provided for in the applicable tax treaty between Brazil and such other country where the recipient of the payment is domiciled.

TRANSFER PRICING RULES

Cross-border transactions (import or export of goods, services and intangible proper ties) entered into between a Brazilian company and a related party abroad, or a party residing in a tax haven jurisdiction, shall 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;

[5] In addition to withholding income tax, payments referring to royalties and technical assistance are subject to 10 percent of new contribution destined to fund the development of technological researches in Brazil. Such new contribution is called "CIDE" (*Contribuição de Intervenção no Domínio Econômico*) and the taxpayer, in this case, is the Brazilian company -thus, provisions of the treaties to avoid double taxation in which Brazil took part are not applicable.

(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 when 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;

(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 income tax rates. Such list is not restrictive and, currently, comprises the following jurisdictions: American Virgin Islands, Andorra, Anguilla, Antigua, Bahamas, Bahrain, Barbados, Barbuda, Belize, Bermuda, British Virgin Islands, Cayman Islands, Channel Islands (Jersey, Guernsey and Alderney), Cook Islands, Costa Rica, Cyprus, Djibouti, Dominican Republic, Gibraltar, Granada, Isle of Man, Labuan, Liberia, Liechtenstein, Madeira Islands, Malta, Marshall Islands, Mauritius Islands, Monaco, Montserrat, Netherlands Antilles, Nauru, Nevis, Nieui, Panama, Saint Kitts, Saint Lucia, Saint Vicent, Samoa Islands, San Marino, Seychelles, Tonga, Turks and Caicos Islands and Vanuatu.

Computation methods

Through different computation methods, it is verified whether the import and export transactions are being conducted in accordance with market prices, and also determined 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 shall 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 shall be considered as a presumed income and included in 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, 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 of May 14,1996,fully effective as of 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, among others, 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. The object in question 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 signatory to the Paris Convention may claim priority rights when applying for a patent in Brazil. The priority right term is twelve months from the first patent application's filing. 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 economical 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 its 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 industrial design application's filing. 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 perceptive 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 may not 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 signatory 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 foreign trademark application's filing. A proof of the prior foreign application is required in order to validate the priority right and shall be presented within four months from the Brazilian application.

Oppositions 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, preliminary relief, etc, from the civil courts.

TRADE SECRETS

Trade secrets are protected under industrial property law in provisions covering unfair competition, which imposes 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 TRANSFERS 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. 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.

SOFTWARE

Computer software is ruled by Law 9,609 of February 20,1998.Software is considered to be 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, provided that they maintain an attorney-in-fact in Brazil to represent the company with respect to matters concerning the respective domain name. Each foreign company, upon registration with FAPESP, is allowed to apply for up to ten domain names using the FAPESP's registration number.

**All amounts referred to in this paper should be used solely for reference purposes and are subject to change. Such amounts are specifically provided for under legislation in Reais (R$) or United States Dollars (US$), as noted in the paper, with two exceptions: The company registration costs quoted in US$ refer to approximate official fees for this service and the fines for anti-trust reporting violations quoted in R$ are based on general market figures.*

Please note that the information provided in this paper refers to the laws and regulations in force in July 2002.It should not be relied upon as legal advice. We therefore encourage you to consult us directly with any specific issues or questions.

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