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Tax

01

Arbitral awards rendered in Brazil are Brazilian, even if the arbitration court is foreign

02

Retrofitting – another possibility for investment in the real estate sector

03

Changes to Brazil's corporations law

04

The new employment litigation clearance certificate

The concept of "input" under non-cumulative PIS/COFINS

05

The new Forest Code

06

EIRELI – Brazil's new single-member limited liability company

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## ARBITRAL AWARDS RENDERED IN BRAZIL ARE BRAZILIAN, EVEN IF THE ARBITRATION COURT IS FOREIGN

In May of this year, the Superior Tribunal of Justice (STJ), Brazil's highest court on non-constitutional matters, confirmed that the nationality of an arbitral award is determined exclusively by the place it was rendered (according to the unanimous decision of the 3<sup>rd</sup> Panel in Special Appeal 1.231.554-RJ, Justice Nancy Andrighi reporting).



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The case involved arbitration before the ICC's International Court of Arbitration, which is located in Paris. The award itself, however, was issued in Brazil by a Brazilian arbitrator, applying Brazilian law and in the Portuguese language, although the STJ's decision did not consider these last three elements to be relevant.

Judgment at 2<sup>nd</sup> instance, rendered by the Tribunal of Justice of the State of Rio de Janeiro (TJRJ), had held that although the award was rendered in Brazil, it should be treated as a foreign decision, since it had been issued under the authority of a foreign arbitration agency, the International Chamber of Commerce (ICC). The TJRJ considered that this conclusion was also consistent with the intention of the parties, since in choosing the ICC, they had wanted to submit the dispute to a foreign decision.

In reversing the TJRJ's decision, the STJ held that the facts that the request for arbitration had been made to the ICC, and that the arbitration was processed under the rules of that institution, did not change the nationality of the award, since it was issued in Brazil. The STJ also found that for the purposes of determining the nationality of an arbitral award, Law 9307/1996 had adopted an exclusively geographical criterion, which is both objective and clear, excluding all other elements (such as the law applicable to the resolution of the dispute, the law governing procedure, the language of the arbitration, the nationality of the arbitrators and the parties, and the domicile of the arbitration chamber).

The STJ's confirmation of the legal criterion for determining the nationality of arbitral awards is timely, and contributes to the security of doing business in Brazil. According



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to information from Brazil's Central Bank, the country is receiving the largest influx of direct foreign investment in its history. For investors who chose Brazil as the place for resolution of disputes, knowing that the arbitral award can be enforced in Brazil without first being confirmed by the STJ is an important consideration, since they will avoid the delay and expense involved in homologation of foreign judgments and arbitral awards.

## RETROFITTING – ANOTHER POSSIBILITY FOR INVESTMENT IN THE REAL ESTATE SECTOR

The growing scarcity of unconstructed land in Brazil's major cities, the sharp upward trend in the value of real estate, and increased construction costs have led investors to see retrofitting and the revitalization of existing constructions as a promising opportunity for investment in the real estate sector.

Retrofitting first arose in Europe, where strict legislation on the preservation of historical and cultural heritage makes it difficult to replace buildings of architectural value with more modern constructions.

With the strict legislation as a spur, the development of retrofitting proved to be the best solution for Europeans to preserve old buildings, while incorporating modern technologies that increase the useful life and functionality of the property. Currently, approximately 50% of the buildings on the European continent have been retrofitted<sup>1</sup>.

Retrofitting consists in preserving, modernizing and giving new value to a property, by using modern technologies and advanced materials to renew façades, architectural structures, electrical and water systems, elevators, and fire prevention and protection systems, among other features, in order to increase the useful life and functionality of the building.

There are various levels of retrofitting. The most extensive is when only the structure of the building is maintained. In all cases, however, retrofitting is more than a simple renovation or restoration, since a renovation seeks only to add improvements to the building, without respecting its original qualities, while the purpose of restoration is to return the building to its original condition, without attempting to modernize it or increase its functionality.

The advantages of retrofitting over ground-up construction are in reduced labor costs per square meter and reduced construction time, which can be cut in half<sup>2</sup>. Experts say, however, that the retrofit must add at least 20% to the value of the property in order to be commercially viable<sup>3</sup>.

Retrofitted buildings can have various uses, depending on the investor's objectives: donation, sale, rental, build-to-suit, and so on. Brazil does not have specific legislation on retrofitting, and consequently retrofitting projects will be subject to the legislation and regulations applicable to the intended use of the building. For this reason, the scope of the retrofitting projects can be limited by municipal building legislation (construction codes), state and municipal zoning legislation, and federal, state and municipal heritage preservation legislation, in addition to rights of vicinage and other general rules under the law of property.

The ownership of the property, whether by a single person, in simple co-ownership, or in condominium (as provided for in Law 4591/1964, with existing independent units), and the intended use of the building (for sale or for lease) are determining factors in establishing the legal structure for the project, which usually involves creating a condominium, or reworking an existing condominium agreement.

Another aspect of retrofitting projects is the importance of respecting any heritage designations that may apply to the property. Heritage designations – or tombamentos, as they are known in Brazil – are made by specific legislation and are intended to preserve properties that have historical, cultural, architectural, environmental or even sentimental value for the population. Buildings that have a heritage designation cannot be destroyed or modified in any way that would change their distinguishing features.

In short, retrofits represent an excellent option for investment in the current real estate scenario, since the reduced construction time and labor costs typical of retrofitting, together with the enormous number of old buildings, offer significant advantages in Brazil's largest cities, where unconstructed land is scarce, real estate prices are increasing rapidly, and construction costs are high. Nonetheless, a detailed legal analysis of the limitations applicable under zoning and heritage designation legislation is essential to ensure that any retrofitting project will be viable.

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<sup>1</sup> Article published on 08/10/2011 at [http://www.mrhengenharia.com.br/mrhengenharia\\_noticias.php?id=6](http://www.mrhengenharia.com.br/mrhengenharia_noticias.php?id=6)

<sup>2</sup> Article published at <http://www.forumdaconstrucao.com.br/conteudo.php?a=22&Cod=925>

<sup>3</sup> Article published at <http://www.urbansystems.com.br/noticias/ler/21304>

## CHANGES TO BRAZIL'S CORPORATIONS LAW

Law 12,431/2011 was published on June 27th of this year, introducing important changes to the provisions under Law 6404/1976 (the Lei das Sociedades Anônimas or LSA) dealing with debenture issues, shareholders' meetings and boards of directors.

### DEBENTURE ISSUES

The amendments introduced by Law 12,431/2011 make the process of issuing debentures simpler, and give companies greater flexibility in their use of debentures. Law 12,431/2011 also corrects a problem in the text governing amortization of debentures, which formerly occurred by "drawing of lots" (sorteio) and now occurs "in proportion" (rateio), which is a far more coherent with the nature of amortization.

The amendments exclude all the limits imposed by law on the issuing of debentures, both the limit based on the issuer's capital and the limit based on the value of the security provided by the company, in the case of debentures secured by fixed or floating charges. In this respect, secured debentures are now treated the same as subordinate debentures, which the LSA did not subject to any limitations, even prior to the changes introduced by Law 12,431/2011.

Furthermore, companies are not longer prohibited from issuing a new series of debentures prior to placing all the debentures under the series of the previous issue or cancelling the unplaced debentures, and are free to negotiate a new series of the same issue prior to placing the previous series, or cancelling the unplaced balance.

The rules on a company's acquisition of its own debentures remain unchanged, and companies may still acquire their own debentures at a price equal to or less than the face value of the instrument, provided the acquisition is disclosed in management's report and the company's financial statements (Article 55 §3(I), LSA). Here, the innovation is in the possibility of companies acquiring their own debentures for a price higher than face value, provided the issuer complies with the rules to be established by the Brazilian securities commission, the Comissão de Valores Mobiliários – CVM (Article 55 §3(II)).

The legislator also gives the board of directors of publicly-traded companies the power to decide on the issue of (i) secured or unsecured non-convertible debentures (Article 59 §1), and (ii) convertible debentures, as long as the company's bylaws provide for the issue of convertible debentures and the authorized capital of the company is not exceeded. Otherwise, the power to approve the issue of convertible debentures remains with the shareholders in meeting (Article 59). The amendments also allow the same fiduciary agent to act under more than one debenture issue by the same company, subject to regulations to be issued by the CVM (Article 66 §3(a)).

Law 12,431/2011 contains other provisions related to debentures that do not, however, amend the LSA. The tax rates applicable to debentures issued by certain special purpose companies (i.e. companies incorporated to implement infrastructure projects) are reduced, provided the debentures are issued before January 1, 2016. The Law also permits debentures to be adjusted for inflation at the same intervals that interest is paid, even if the adjustment occurs more than once a year, which was formerly prohibited.

### SHAREHOLDERS' MEETINGS

According to Article 100 §2 of the LSA, as amended by Law 12,431/2011, the Book of Minutes of the General Meetings of Shareholders and the Book of Attendance at Shareholders' Meetings of publicly-traded companies can now be replaced by mechanical or electronic records, which the legislation formerly permitted only for the Share Register and Share Transfer Register.

Another innovation is remote participation in shareholders' meetings (Article 121, sole paragraph, and Article 127, sole paragraph), subject to regulations to be issued by the CVM. It is possible that remote participation will be implemented by electronic signature and digital certifications.

CVM Instruction 481/2009 had already provided for voting under an electronic proxy. However, the shareholder's agent was still required to attend the shareholders' meeting in person in order to exercise the proxy.

Thus, the change introduced by the new legislation benefits not only shareholders, who will have available faster and more effective mechanisms for exercising their rights to participate in and vote at shareholders' meetings, but also companies, especially those located outside the Rio – São Paulo axis, which sometimes have difficulty in meeting the quorum for doing business or the majorities for approval of some matters established under the LSA (as in the case of amendments to the bylaws, which require a quorum of 2/3 of the company's capital at first call, and corporate splits, which require the approval of shareholders representing at least half of the company's capital).

### BOARD OF DIRECTORS

Law 12,431/2011 repeals part of Article 146 of the LSA, and in doing so puts an end to the requirement that members of the board of directors also be shareholders of the company. This formality, which has long been banned in other countries, had become outdated, particularly with the increasing professionalization of corporate management. In practice, the legal requirement was met by the transfer of a single share to the director, in trust, usually by the controlling shareholder, with the share being returned at the end of the director's mandate. The change is welcome, since in today's market directors' professional qualifications and reputation are much more important than any shareholding they may have in the company they serve.

## THE NEW EMPLOYMENT LITIGATION CLEARANCE CERTIFICATE

In July of this year, Law 12,440 created the *Certidão Negativa de Débitos Trabalhistas* – CNDT, or employment litigation clearance certificate.

According to Law 12,440, beginning in January 2012, companies that wish to participate in public bids for service contracts with the federal administration, federal agencies, public foundations, state-owned companies and mixed economy companies will be required to present a CNDT.

According to the legislation, CNDTs will be issued electronically by the Labor Courts. Law 12,440 does not specify, however, which body within the Labor Judiciary will be responsible for issuing the certificates. However, given that the legislation applies throughout Brazil, we expect that the *Tribunal Superior do Trabalho*, the country's highest court in labor matters, will issue the certificate by means of its website.

Once issued, CNDTs will be valid for 180 days. Although Law 12,440 requires that a valid certificate be presented by each participant in the qualification phase of public bids, it does not expressly state that the successful bidder is required to renew its CNDT every 180 days.

Contrary to appearances, the purpose of the CNDT is not to prove that the company does not have any outstanding employment and labor-related debts, or that the company is not a defendant in litigation pending before the labor courts. What the CNDT is intended to prove, in fact, is that even when an employer has labor liabilities in the form of pending lawsuits, the employer does not attempt to evade payment when judgment is issued against it as the case moves into the liquidation phase. Thus, only companies that have either failed to pay the amount owed under judgments, or to pay security for the judgment into court within the legal time period, will be unable to obtain a CNDT.

The CNDT will apply to all a company's establishments, agencies and branches.

As can be seen, for the purposes of government contracting, it is more important for companies to be "good judgment debtors" in labor and employment actions than to be "good employers". The new CNDT requirement means that companies will have to monitor their labor and employment litigation carefully, and adjust their financial planning to enable them to pay labor judgments if they want to avoid being surprised by execution proceedings that will deprive them of the opportunity to bid on government contracts.

## THE CONCEPT OF "INPUT" UNDER NON-CUMULATIVE PIS/COFINS

Exactly what constitutes an "input" (*insumo*) for the purposes of calculating PIS and COFINS credits is a much-discussed topic in both the specialized legal literature and the case law. PIS (*Programa de Integração Social*, or Social Integration Program) and COFINS (*Contribuição para o Financiamento da Seguridade Social*, or Social Security Financing Contribution) are federal contributions that are calculated on the basis of a business's gross revenues.

Brazil's Federal Revenue Service, and a number of court decisions, have adopted a restrictive interpretation, taking the position that the criteria for determining which "input" will generate credits for PIS and COFINS purposes should be the criteria used for the federal excise tax, the IPI (*Imposto sobre Produtos Industrializados*, or Manufactured Products Tax). In other words, inputs should be limited to those used in the manufacture of a product or in the provision of a service, within the meaning of Federal Revenue Service Instructions 247/2002 and 404/2004.

In our view, however, this strict interpretation of "input" is not consistent with the economic basis of PIS and COFINS, which is not formed simply by the manufacture of products or the provision of services.

In reality, the concept of "input" should extend to all the steps that result in the product or service, and even to post-production and post-service phases, as long as the "input" is essential to production. Under this interpretation, inputs would include expenses incurred in warehousing, product delivery, and inventory control, since all are required to ensure that the chain of production continues to function.

Following this line of reasoning, and given the logical inconsistency of applying the definition of input under IPI legislation to PIS and COFINS, the correct solution would be to use the concept of costs and expenses used for calculating corporate income tax, as provided for under the Income Tax Regulations.

This is precisely the reasoning adopted at the administrative level in a recent decision by the *Conselho Administrativo de Recursos Fiscais* – CARF, the tax appeals board, and at the judicial level in a recent decision by the 4th Region Federal Appeals Court (*Tribunal Regional Federal da 4ª Região*).

Both decisions find that the concept of "input" used for income tax should be applied in determining what amounts can be deducted in calculating PIS and COFINS.

Although neither of the decisions has become final, we believe that they represent an advance in the interpretation of the concept of "input" for the purposes of PIS and COFINS, given that simply importing the meaning of "input" for IPI purposes is not consistent with the nature of PIS and COFINS or their application.

## THE NEW FOREST CODE

On May 25, 2011, Brazil's Chamber of Representatives, the Câmara dos Deputados, approved Bill 30/2011 (Bill 30), which contains the text of the New Forest Code.

The Bill establishes general principles for the protection of vegetation, provides for Permanent Preservation Areas and Legal Reserves, and sets out general rules governing the use of plant resources, the supply of raw materials sourced in forests, the control of the origin of forest products, and the control and prevention of forest fires.

The main changes to the existing Forest Code under Bill 30 are:

- **Consolidated Rural Area** – Article 3 introduces the concept of the "Consolidated Rural Area", which is defined as an area occupied by humans, containing buildings, improvements, and agricultural or forestry activities, established on or before July 22, 2008. Under the Bill, agricultural and forestry activities in Consolidated Rural Areas located within Permanent Preservation Areas, Legal Reserves and Restricted Use Areas will have protected status as long as (i) the illegal clearing of land occurred prior to July 22, 2008, (ii) the soil, biodiversity and water resources are preserved, and (iii) the owner or occupant registers the Consolidated Rural Area with the state environmental agency.
- **Permanent Preservation Area (PPAs)** – The protected strip along the margins of rivers and streams will be measured from the edge of the normal bed, rather than from the high-water mark, as is currently the case. The protected strip for water courses less than 10 meters wide will be reduced from 30 to 15 meters in Consolidated Rural Areas. In addition, PPAs on the summits of mountains and hills will be subject to a number of limitations, such as a minimum height of 100 meters and an average incline of more than 25°.
- **Legal Reserve** – The percentage of rural properties that are subject to Legal Reserve remain unchanged. However, owners and possessors of small rural properties (having an area of up to 4 "modules") will no longer be required to restore Legal Reserve areas that have been illegally cleared, although they will be required to preserve any remaining area. The Bill also provides that Permanent Preservation Areas may be included in calculating a property's Legal Reserve, as long as the calculation does not result in new clearings, the calculated area has been preserved or is in the process of being restored, and the owner or possessor of the property has applied to register the property in the Environmental Register. Lastly, property owners who wish to exclude the Legal Reserve area on one property by offering an equivalent area on another property will be able to offer any area that is of equal or greater environmental importance and belongs to the same biome, rather than the same microbasin.
- **Environmental amnesty** – Property owners will be able to enter into administrative settlements, but the program will only be open for properties where illegal clearing of native vegetation occurred prior to July 22, 2008. Owners who enter into administrative settlements will benefit from a suspension of penalties related to illegal clearing in Legal Reserve areas, Permanent Preservation Areas, and on slopes with an inclination of 25° to 45°.
- **Instruments to preserve plant life** – Government initiatives will include a) voluntary preservation of native vegetation, b) environmental restoration in Permanent Preservation Areas and Legal Reserves, and c) restoration of degraded areas, as well as programs offering payment for environmental services such as carbon capture and retention, and protection of biodiversity and water resources.
- **Environmental Register** – The Bill creates the Rural Environmental Register (Cadastro Ambiental Rural – CAR), in order to centralize environmental information on rural land. The Bill makes registration in the CAR mandatory for all rural properties, and only owners of registered properties will be eligible to apply for authorization to clear native vegetation.

Bill 30 is now before the Federal Senate. Hearings and meetings of various Senate committees are being held prior to the vote that will approve, or not, the New Forest Code.

## EIRELI – BRAZIL'S NEW SINGLE-MEMBER LIMITED LIABILITY COMPANY

Law 12,441 of July 11, 2011 amends the Brazilian Civil Code (BCC) to create the new single-member limited liability company, known as the empresa individual de responsabilidade limitada or EIRELI. The introduction of the EIRELI is a great advance in Brazilian law, as it does away with the need to have at least two partners in order to incorporate (and maintain) a limited liability company or sociedade limitada. Prior to Law 12,441, anyone who wished to incorporate a company with its own assets, obligations and liabilities was obligated to have a partner, even if that partner's participation in the company was symbolic only, and amounted to a mere formal presence to meet the legal requirement for creation of a limited liability company.

Under the amendments to the BCC, both individuals and legal entities can now incorporate an EIRELI. Interestingly, the bill that would become Law 12,441 originally provided that only individuals could create EIRELIs, and that an individual could be the owner of only a single EIRELI at any one time. This provision was modified to allow EIRELIs to be incorporated by legal entities as well, although the restriction on the number of EIRELIs any one individual can own remains in place, with the result that legal entities are permitted to incorporate more than one EIRELI.

Law 12,441 does not classify EIRELIs within the existing forms of business organization but instead defines them as a new form of legal entity. It follows that EIRELIs are also distinct from the only other form of legal entity under Brazilian law that can have a single member – the wholly-owned subsidiary, which is provided for under the Corporations Law, Law 6404/76. However, there are contradictions in the text of Law 12,441, which states that the expression "EIRELI" must be included after the company's business or "corporate name" (denominação social), which only corporations have, and provides that the rules governing limited liability companies will apply to EIRELIs, to the extent compatible.

EIRELIs can be incorporated directly, or can result from transformation, when the whole of the quotas in another type of company are held by a single person, if the single quotaholder applies for transformation with 180 days. EIRELIs are required to have a capital of not less than 100 times the highest minimum monthly salary in effect in the country, and the capital must be fully paid in.

One controversial point relates to the separation of EIRELIs' assets and liabilities from those of its owner. Originally, the bill that became Law 12,441 expressly provided that an EIRELI's assets and liabilities are separate from those of its owner. This provision, however, was vetoed by the President, on the grounds that the provision could generate doubt as to the application of the rules on lifting the corporate veil that are contained elsewhere in the BCC. Although the reasons for the veto affirm that the rules governing limited liability companies apply to EIRELIs, including the rules on the separation between the assets and liabilities of the legal entity and those of its quotaholders, there is some question as to whether that affirmation will be sufficient to ensure that owners do not become liable for their EIRELIs' obligations. Without effective limitation of liability, EIRELIs will be of little use in practice.

The amendments made by Law 12,441 will come into force in January 2012, giving the National Commercial Registry Department (Departamento Nacional de Registro de Comércio) time to issue rules on the practical formalities of incorporating EIRELIs and registering them with the Boards of Trade.

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