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A MULTIDISCIPLINARY APPROACH TO INFRASTRUCTURE

Symbolized by the opportunities represented by the pre-salt oil reserves and the infrastructure needed to host the 2014 World Cup and the 2016 Olympic Games, the wave of investment that has taken hold in Brazil in recent years will make even greater demands on Brazilian law firms, according to BM&A partner Plínio Simões Barbosa, one of the attorneys responsible for creating the firm's multidisciplinary infrastructure projects team.



Plínio Simões Barbosa, founding partner of BM&A

"Infrastructure projects are complex and require specialized support in various areas of the law. But it's not enough to put together a group of lawyers who are excellent practitioners in their areas of specialization – they also have to have experience with infrastructure, be able to work as a team and develop a multidisciplinary approach to problems. BM&A has created an Infrastructure Group exactly for this purpose – to ensure that specialists in project finance, equity markets, tax, and regulatory matters form an integrated team that will build on the team members' previous experience in infrastructure projects, establishing a pool of knowledge and solutions to problems in the sector. The result is more efficient and effective service for our clients," says Barbosa.

BM&A was formed and consolidated its practice over a period that presented some of the greatest challenges for corporate law in Brazil's recent history: the last 15 years have seen privatizations in the transportation, mining, steel and telecommunications sectors, while at the same time the national financial system was overhauled. As a result, BM&A is used to dealing with novel issues, as Barbosa points out: "We are constantly dealing with situations that are so new that sometimes the regulatory framework is not yet entirely in place. In these circumstances, a legal adviser's experience and multidisciplinary vision are essential factors in developing solutions that give real security to the client."

In recent years, BM&A has advised clients in a wide range of infrastructure projects, from the licensing, financing and construction of greenfield projects to government and private contracts for goods and services in the energy, transportation, sanitation, telecommunications and real estate sectors, to name a few. This experience and interaction with executives from a large variety of economic sectors leads Barbosa to believe that the incentives in the infrastructure sector will generate a new wave of investment in the base industries and secondary services, which will necessarily result in new industries and a natural process of consolidation and reorganization in various segments of the economy.

Another big challenge in infrastructure projects is the governmental component. The government is always present in infrastructure projects, as the regulator, the grantor, the lessor, the licensor or, at a minimum, the purchaser of goods and services. "The presence of government in infrastructure projects has a huge legal impact and requires specialized lawyers. In the private law, the rule is that if something is not prohibited, it is almost always permitted. In public law, whatever is not permitted is prohibited. Without the proper training and experience, lawyers can make serious mistakes," emphasizes Barbosa.

In fact, BM&A was one of the first business law firms to create a specialized public law practice area. More recently, the firm's innovative approach has led it to give special attention to the rules and policies on dealings with government in Brazil and abroad, and particularly the FCPA in the United States and Europe's Anti-Bribery Acts. BM&A has organized international seminars on the subject and in-house training programs for its own attorneys and for clients.

"We know we have to keep up with the constant changes and new trends in business and in the law, both nationally and internationally, in order to understand and meet our clients' needs."

MULTIPLE OPPORTUNITIES IN THE INLAND WATERWAYS, PORTS AND SHIPBUILDING SECTOR

Among the many infrastructure sectors in Brazil that currently foster investment opportunities, the inland waterways, ports and shipbuilding sector, known as the "setor aquaviário" or "waterways sector" in Brazil, is probably the sector which has grown the most in the last decade. Law 8,630/93 – the Port Modernization Law, initiated the structural reform of the sector, and the creation of the National Waterway Transportation Agency (Antaq) in 2001 established the sector's regulatory framework. But beyond the legal framework, sectoral incentives and macroeconomic factors, the key factor in the current growth of this sector is the expansion of the oil and gas industry over the last decade.

Oil discoveries and the prospect of oil production from the pre-salt layer have triggered ever-growing demands on the sector. In Petrobras' Tupi field alone, Petrobras is expected to produce approximately 500 thousand barrels of oil a day between 2015 and 2020. This is a new standard of production that imposes urgent improvements in several aspects of the domestic industry. Against this backdrop, the port sector is vital to ensuring not only the delivery of supplies to oil platforms, but also the renewal of the domestic fleet and repair and maintenance of oil vessels and platforms.

Brazilian legislation limits port and shipping services to Brazilian companies and Brazilian flag vessels, with some legal exceptions. Nevertheless, Antaq data show that between 2007 and the beginning of last year, 20 new authorizations were granted to offshore support companies. Today, over 100 companies authorized by Antaq for these services operate a 267-vessel fleet, out of which 132 are Brazilian and 135 are foreign flag vessels. However, significant changes in these percentages are expected once the pre-salt reserves enter the production phase.

According to data from the National Shipyards Association (Sinaval), there is a confirmed demand for 146 new units in supply boats alone projected to be built in Brazilian shipyards by 2015. Sinaval data show that, in order to meet this demand, the number of shipyards in Brazil is expected to reach at least 32, with the construction of 11 new shipyards, mostly in the Northeast Region.

There has also been a progressive increase in the number of ports available. In this respect, Antaq Rule N. 1,660/2010 governs the grant of authorization to construct and operate shipyards and logistics bases for the oil and gas industry in the form of private port terminals. Hence, the oil and gas industry will be catered to with more logistically and economically-effective options.

But the expansion of the port sector, albeit boosted by this market niche, is not due to the growth of the oil and gas industry alone. Currently, Antaq recognizes four different types of port facilities aside from the Organized Ports, which may be operated by private companies, namely: (i) Exclusive Use Private Terminals (Exclusive PUT), which operate their own cargo exclusively or give logistic support to the oil and gas industry, as mentioned above; (ii) Mixed Use Private Terminals (Mixed PUT), which operate their own cargo and third party's cargo; (iii) Private Use Terminals for Tourism (Tourism PUT), for movement of passengers; and (iv) and Small Public Port Facilities (PF 4), which cater for states and municipalities.

Notwithstanding the plethora of opportunities, the fact remains that, as a rule, investments in the port and waterways sector are long-term and demand significant amounts of funds. In this scenario, project financing is crucial, as described in this issue's article "Infrastructure Projects Financing in Brazil", which describes some of the factors investors and lenders should take into account. Without financially and legally sound equations, lenders will be left with little or no certainty as to their commitments. There are specialized corporate, banking and regulatory issues involved in infrastructure projects, and the role of the BM&A's Infrastructure Group is to help clients identify and handle those issues.

INFRASTRUCTURE PROJECTS FINANCING IN BRAZIL

The push toward sustainable growth of the Brazilian economy and the major events that the country will host over the next five years have brought infrastructure into the spotlight. As a result, financing for infrastructure projects has also gained in importance. The purpose of this article is to comment on the usual financing structures for infrastructure projects in Brazil and the risks associated with each of them.

Unlike other countries, financing for infrastructure projects in Brazil tends to be a mix of corporate finance and project finance, in order to ensure that the project's risks are fully transparent and to allow each investor to select its portion of the risks.

The financing structures that usually serve as sources of funding for infrastructure projects are risk capital, loans and hybrid debt/equity instruments such as convertible debentures, with the accompanying grant of security. Contractual performance bonds for such things as supply of the project's essential components and sale of the project's end product are also required.

Accordingly, negotiating the network of agreements inherent to infrastructure financing transactions involves two major elements: equity and debt.

Equity financing can take different forms, depending in large part on whether the project is essentially a greenfield or a brownfield project. Debt financing, an equally important element, can take the form of highly sophisticated financial instruments, involving financial institutions and development banks.

The network of project agreements is thus formed of different kinds of contracts and different parties, and includes the instruments needed for the project's sponsors to invest in the project. The main objective of this network of agreements is to mitigate the risks inherent in the project.

According to the theory of allocation of risks inherent in project financing transactions, risks should be borne by the party that is best able to absorb them. Thus, the construction risks should be assumed by the contractor, preferably through a turn-key contract, so that the project sponsors can demonstrate to financiers that there is a third party that is effectively liable for putting the plant into operation. In contrast, the logistics risk, for example, can be mitigated through a network of agreements for delivery of productions, in function of the offtake agreements, which ensure that the project's future production will have a purchaser.

Following this logic, part of the risk inherent to any infrastructure project should be mitigated by the capital put up by the project's sponsor or group of sponsors. Usually, investments in infrastructure projects are made through (i) a Special Purpose Company (SPC) incorporated by the project sponsor or sponsors, with a capital of about 20% to 30% of the amount needed to carry out the infrastructure, paid up in property or cash; (ii) a holding company that controls subsidiaries dedicated to each activity required to implement the project; and, in order to attract a broader range of investors, (iii) public offering of units in a private equity fund (or FIP as they are known in Brazil – *Fundo de Investimento em Participações*) with restricted sales efforts under CVM Instructions 476/2009 and CVM Instruction 391/2003. Thus, investors can choose between investing directly in the SPC, in the holding company or in the FIP, which will be one of the shareholders in the holding company's or SPC's control block, depending on the project's structure.

Limitation of liability will be a decisive factor for project sponsors when structuring the risk capital they will put into the project. The fact there is no mechanism under Brazilian law that allows assets and liabilities to be attached to a specific project, shielding the sponsors from liability and providing comfort to third-party investors and lenders, and the fact that infrastructure transactions involve a variety of different kinds of risks, makes the task a difficult one, and structuring infrastructure transactions inevitably require a network of agreements that clearly allocate the risks involved in the investment.

Regardless of the structure adopted, the voting and other rights attached to the shares held by the sponsors in the SPC or holding company should be agreed on in advance by means of a shareholders' agreement. Sponsors' shareholders' agreements are intended to govern the relationship between the sponsors, by setting out their rights over the capital they have invested (exercise of control, rights of first refusal on the sale of shares, tag-along and drag-along rights, etc.), and to prepare the company to receive funds from future investors. Depending on the nature of the financing agreement or securities issuance, the future investors may require the control group to enter into another shareholders' agreement, in order to protect the funds injected by the new investors.

Debt financing can take different forms, and the choice will depend largely on the nature of the project, the amount of the financing, and the financial institution involved.

Recently, for example, BNDES, Brazil's economic development bank, announced its intention to purchase up to R\$10 billion in debentures

issued in connection with infrastructure projects. In addition, Provisional Measure 517, issued on December 30, 2010, creates tax exemptions and reductions for income earned on debentures issued in connection with infrastructure projects.

In January of this year, the National Monetary Council issued Resolution 3947 to regulate certain aspects of Provision Measure 517/2010, and in February the CVM, Brazil's Securities Commission, began public consultation on the impact of the Provisional Measure in connection with possible amendments to the regulations governing long-term debt transactions in Brazil. Provisional Measure 517 is now before the federal House of Representatives and may be amended before it becomes permanent legislation.

Regardless of whether they supply debt or equity financing, lenders and investors will seek to mitigate the risks involved in the infrastructure project by means of a security package that takes into account the various phases of the project. In general, the package can be divided into two phases:

▪ PRE-OPERATIONAL PHASE

the pre-operational security usually takes the form of personal guarantees granted by the controlling shareholders of the project's SPC or holding company, advance capital contributions, commitments to make additional capital contributions for implementation of the project (construction and final commissioning), and performance bonds;

▪ OPERATIONAL PHASE

in the operational phase, the security package will include instruments such as a pledge or assignment in trust of shares in the SPC or the holding company, a pledge of the project's receivables (and the associated deposit account), and a mortgage over the project's equipment and/or the entire plant.

In addition to the security package, various covenants can be made in the financing agreements. Covenants are simply accessory contractual obligations and can be either positive or negative. The most common covenants in infrastructure projects are: (i) maintenance of the control block; (ii) prohibition against amendments to the project agreements without the financing parties' prior consent; (iii) restrictions on contracting new debt; (iv) requirements to contract and maintain various types of bonds and insurance, with the lenders named as beneficiaries; and (v) prohibition against distribution of dividends until a certain date and/or until a certain portion of the financing is repaid.

A good example of the issues involved in financing infrastructure projects is provided by the biofuel sector in Brazil. In the case of ethanol, growth of the sector was spurred by the mandatory percentages of ethanol in gasoline fuel and the increased numbers of flex-fuel automobiles, which are expected to make up 65% of the total fleet by 2015; in the case of biodiesel, expansion is largely due to Law 11,097 of 2004, which made it mandatory for diesel fuel to contain 2% biodiesel in the period from 2008 to 2012, and 5% from 2013 on.

The investment made by sponsors in biofuel projects, whether singly or in a group, will take into account the risks involved in the production of ethanol or biodiesel. Commonly, the risks are associated with: (i) construction of the ethanol or biodiesel plant; (ii) supply of raw material (soybeans or sugar cane); (iii) the logistics of transporting the ethanol or biodiesel; (iv) environmental issues, especially risks related to obtaining the required environmental licenses and any environmental protection areas neighboring the sugar cane or soybean plantations; and (v) labor and employment issues, and particularly labor standards requirements, in view of the large number of workers involved in production.

In order to mitigate these risks, projects in the biofuel sector are usually structured as a holding company with subsidiaries for each activity – (i) cultivation of crops; (ii) transportation and logistics; and (iii) energy production.

BM&A WELCOMES A NEW PARTNER

Wagner Garcia Botelha is BM&A new real estate partner.

Wagner Botelha holds a Bachelor of Laws degree from PUC-Campinas and a specialization in Corporate Law from IBMEC-INSUPER. He is a permanent member of the Commission for Real Estate and Urban Planning Law of the São Paulo section of the Brazilian Bar Association, and a member of the São Paulo's Attorneys' Association and the Portuguese Bar Association.

Botelha brings 13 years' experience in real estate projects and infrastructure in general, especially in the oil and gas, electrical energy, ports and hotel sectors, acquired through his practice in large international law firms in Brazil and abroad.

ENVIRONMENTAL LICENSING AND MAJOR CONSTRUCTION PROJECTS

Clear and objective rules that focus on what, in practice, are the environmental consequences of large construction projects and that reduce the scope for subjective assessment by technical personnel within environmental agencies are what every Brazilian entrepreneur – and foreign investor in infrastructure projects – wishes for.

It seems that the Brazilian government is now beginning to pay real attention to that wish. The federal government has been closely monitoring the difficulties faced in implementing major works such as the Belo Monte Hydroelectric Station, showing considerable discomfort at the stumbling blocks in the way of that and other projects fundamental to the federal Growth Acceleration Program (PAC). The federal government has also faced defiance from the public administration in the form of successive resignations by senior managers in IBAMA, the main federal environmental agency, and challenges by federal prosecutors.

At the beginning of the year, President Dilma Rousseff announced a series of Presidential Decrees that will simplify the environmental licensing process. The Decrees will deal with projects in the energy, infrastructure and transportation sectors. More controversial areas, such as hydroelectric and nuclear power stations, will not be the target of changes at this time.

With specific rules for each sector and clearer technical criteria for assessing environmental impacts and determining measures to mitigate and compensate those impacts, the Decrees also seek to reduce the "grey areas" in the regulations, which give room for discretionary and subjective decision-making by environmental agencies. A typical point of uncertainty is the social and environmental requirements imposed by the agencies in the course of the licensing process. Despite the fact that the legislation does not provide for such requirements, in practice they represent a condition for the grant of environmental licences.

The numbers demonstrate that the situation is, in fact, critical, and any movement toward simplifying the environmental licensing process will not only to alleviate investors' concerns, but will also serve the interests of federal government, which has made upgrading Brazil's infrastructure one of its priorities. According to information published in March of this year, there are more than 1600 licensing applications under review by IBAMA in connection with 1300 projects that are important to Brazil's development.

Under the Federal Constitution of 1988, Brazil has assumed a commitment to conserve its natural resources, and not exhaust

them. That commitment does not mean, however, that the country's resources cannot be used. The real issue is how the resources should be used and how the State will organize the system that will supervise and control that use. It is precisely in the organization of the system for supervision and control of the use natural resources that the federal government intends – and indeed must – take urgent action.

Now that the tool for that action has been chosen – the Presidential Decree, which is provided for in article 84 of the Federal Constitution – Brazil is ready to begin work on a new aspect of the PAC: the "licensing acceleration program". A faster licensing system does not mean a system that is less effective in protecting the environment: the current barriers, set out in unclear, contradictory and overlapping regulations, have resulted in a "slow motion" licensing process that, at the end of the day, does not necessarily ensure better protection for the environment.

At present, the licensing process at both the federal and the state level is based on a large number of studies. The volume of information and the method of assessing that information do not contribute to consolidating a system that truly operates to the benefit of Brazil's current and future generations.

The uncoordinated action and overlapping jurisdictions of other agencies within the federal government, such as those dedicated to protection of historical sites or specific populations (the *quilombola* and indigenous peoples, for example) or to maintaining environmental conservation units, also creates very significant obstacles to obtaining environmental licences.

The truth is that obtaining an environmental licence in Brazil is an unpredictable and discouraging process from the outset. Even deciding which agency has jurisdiction over the licensing process for any given project can be a difficult question to resolve for the entrepreneur. The limits of jurisdiction are not clear even to the environmental agencies themselves, and the federal government should give special attention to establishing clearer rules on the division of powers between environmental agencies.

Is the initiative taken by Brazil's new president praiseworthy? Unquestionably. Will it make a real difference? That remains to be seen. What is certain is that the "land of the samba" will not achieve the coveted developed nation status unless it consolidates the current licensing process into a system for supervision and control of sustainable use Brazil's resources that allows economic development and environmental protection to "dance to the same beat".

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THE OLYMPIC PACKAGE

Incentives to The Hotel Industry in The City of Rio de Janeiro

Rio de Janeiro's natural vocation for tourism, coupled with the approaching 2014 Soccer/Football World Cup and the 2016 Olympic and Paralympic Games, have attracted an increasingly higher number of investors and hotel chains from all over the globe.

At the end of 2010, the "Olympic Package" was sanctioned to meet the demand for accommodation for the 2014 World Cup and, particularly, the 2016 Olympic Games and cover the estimated deficit of approximately 8000 hotel units in the city of Rio. The backbone of the Package is Supplementary Law 108/2010 and Municipal Laws 5,229 and 5,230/2010, which relax urban planning laws and offer tax incentives for the construction of new hotels, with a view to preparing Rio de Janeiro to host these major world events.

The legislation prioritizes sustainable construction and establishes that properties to be used for constructing hotels, resorts, bed and breakfasts and hostels and/or for conversion or use of existing buildings for temporary accommodation will enjoy special zoning and density parameters. This permission applies exclusively to some city areas, such as the downtown and the port areas (which already benefit from "Porto Maravilha" Project), Rio Comprido, Flamengo, Ilha do Governador, São Conrado, Itanhangá, Barra da Tijuca and Jacarepaguá. In regions such as Guaratiba and Alto da Boa Vista, investors can take advantage of Rio de Janeiro's natural beauty through the construction and management of ecological resorts.

The Package also offers investors attractive tax incentives concerning real property purchased by December 31st, 2012 for the construction of hotels, bed and breakfasts, hostels or resorts. Some of the main incentives are exemption from Real Property Transfer Tax (ITBI), remission of Urban Property Tax that fell due before Law 5,230/2010 was published, and exemption from Urban Property tax during the construction.

The new legislation also provides for a new Services Tax (ISS) rate, which fell from 5% to 0.5% for construction services and hotel property renovations performed by December 31, 2015. An exemption from ISS applies to construction works contracted by the Olympic Games and the World Cup Organizing Committees, from publication of Law 5,230/2010 to the 60th day after the end of the events.

These tax benefits do not apply to motels, shelters, school residences, boarding houses, lodges or residential houses outside the downtown and the port areas. Furthermore, in order to enjoy the tax benefits, the proper licences must be obtained, and the building must be certified for occupancy by December 31, 2015. Entrepreneurs are also required to allocate at least 90% of the constructed units to the 2016 Olympic Games Organizing Committee, for no longer than 60 days and at market price. The legislation also mandates maintenance of hotel services and prohibits any change in the use of the buildings.

There are enormous opportunities in this sector in the coming years, and Rio de Janeiro is clearly committed to exploiting its potential for tourism to the full.

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