

NEW INCENTIVES FOR RAISING FUNDS ABROAD

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Recently, some exchange related regulations were enacted by the National Monetary Council ("CMN") and by the Central Bank of Brazil ("BACEN") demonstrating the national monetary authorities' new tendency towards a more flexible exchange market in Brazil. It is expected that such regulations will serve as a strong motivation to increase the raising of funds by Brazilians abroad and, consequently, to raise the amount of foreign investments in Brazil.

The first regulation is Resolution CMN no. 3,217, dated 06.30.2004, which permits early liquidation of obligations related to (i) foreign credit transactions, which include those contracted directly or through the placement of securities abroad; (ii) credit transactions linked to exports (usually called "export securitization"); (iii) commercial leases; (iv) import related financings; and (v) technology related financings.

The "pre-payment" of foreign obligations had already been permitted by the CMN and BACEN in the nineties by Resolution CMN no. 2,105 dated 08.31.1994 and by BACEN Comunicado no. 4,192 dated 09.23.1994. It is interesting to note that this regulation expressly established that the transfer of funds abroad with a view to early liquidation, allowed by Resolution CMN no. 2,105/94, did not depend on prior authorization from the BACEN and should proceed in compliance with the respective certificate (a printed certificate of registration which was the system used at that time for registration of foreign capital) or payment scheme.

However, such regulation did not last very long and, on 03.09.1995, Resolution CMN no. 2,147 prohibited the "pre-payment" of foreign obligations, which lasted until the recent enactment of Resolution CMN no. 3,217/04. Until now, Brazilian debtors planning on early liquidation of their foreign obligations had to submit to the BACEN a request for prior authorization for "pre-payment" and the BACEN, at its own discretion, would grant the requested authorization or not, based on a case by case examination. The spirit of the prohibition of "pre-payments" was to repress early departures of funds from the country through the execution of exchange contracts – which could adversely affect the equilibrium of payment balances in Brazil – and, therefore, many times such requests were denied by the authorities.

With the current regulation, the early departure of funds is now more flexible, granting the contracting parties freedom to terminate a contractual relationship that is no longer of interest.

However, it is important to note that Resolution CMN no. 3,217/04 has still not been regulated by the BACEN and, therefore, in practice, "pre-payment" still depends on the granting of specific prior authorization by the BACEN. It is expected, however, that the BACEN will make a formal announcement, along the same lines as the regulation issued on the matter, in which it admits that the referred to transaction be performed regardless of any authorization or announcement.

Another measure which certainly seeks to motivate the raising of funds abroad and foreign investment in Brazil is related to the new conditions for issuance and placement of real denominated securities abroad (Resolution CMN no. 3,221, dated 07.29.2004), as well as the respective form of registration (Circular BACEN no. 3,250, dated 07.30.2004).

Contracting foreign loans in Brazilian currency had already been allowed by the CMN ever since the implementation of the new system involving foreign loans, in accordance with Resolution CMN no. 2,770, dated 08.30.2000. Nevertheless, such regulation established that the payments made in connection with loans in Brazilian currency should necessarily be made using a non-resident account maintained by the foreign creditor in Brazil. In other words, such transaction

would only be viable in the event the creditor opened a non-resident account in a financial institution headquartered in Brazil (the so-called “CC-5”, currently regulated by Circular BACEN no. 2,677/96), in order for the payments of principle and charges related to the loan granted in Brazilian currency to be processed through the International Transfer of Reais mechanism (“TIR”).

As of now, with the enactment of Resolution CMN no. 3,221/04, such payments may be made, alternatively, in a foreign currency – in other words, by closing an exchange contract –, regardless of the currency stated on the registration (reais in this case). Please note that the amount in foreign currency apt for remittance abroad should correspond to an amount, in reais, related to the payment of principle of the securities and interest and other accessory charges that apply to the transaction.

In light of the above, the CMN and the BACEN granted more certainty and security to foreign investors in connection with the form of repayment of the loans in question, the remittances of which shall no longer depend on the availability, in the future, of the TIR mechanism. Therefore, the intention is to encourage a way to raise funds abroad in such a way that the Brazilian borrower is not subject to the risks of exchange devaluation (which had a strong impact during recent years on many Brazilian companies with debts linked to exchange variations), in addition to giving foreign investors the possibility of having the benefit of high interest rates paid in the past in Brazil and a possible valuation of the real in relation to the American Dollar.

Still with respect to the raising of funds abroad, it is important to highlight Law no. 10,925, dated July 23, 2004, which through article 12 maintains for the renegotiation of maturity dates of securities issuances abroad (a) an average amortization term of at least 96 months and (b) valid as of December 31, 1999, a reduction to zero of the rate of income tax retained at source, applicable to the respective income gained in Brazil by individuals or legal entities residing or domiciled abroad, corresponding to interest, commissions, expenses and discounts.

Such tax benefits shall be maintained provided the conditions are complied with (such as compliance with the average amortization term) and provided renegotiation complies with the conditions established by the BACEN, including with respect to interest rates.

It is important to recall that through Provisional Measure no. 2,189-49, dated 08.23.2001 (still in force today), the Brazilian tax authorities had allowed that capital increases carried out through the conversion of foreign obligations, which were granted the tax benefit in question, be performed maintaining the rate at zero; however, during the period of time remaining for the final liquidation of the capitalized obligation, the following was forbidden: (i) restitution of capital, including by extinguishment of the legal entity and (ii) transfer of the respective shares or quotas to individuals or legal entities residing or domiciled in Brazil.

THE COMPANY REHABILITATION LAW AND ITS IMPACT ON FINANCIAL TRANSACTIONS

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In the event the Company Rehabilitation Law is completely approved by the House of Representatives and sanctioned by the President, it will substantially change legal relationships between creditors and debtors. The new law – if approved, shall replace the current bankruptcy legislation – will introduce concepts that will perfect the recovery of credits in general and, at the same time, allow companies in debt to recover financially. This subject was previously approached from a corporate standpoint – specifically with respect to the withdrawal of shareholders – by Francisco Müssnich and Laura Bumachar (edition no. 4 of the BM&A Review). With respect to financial and capital markets, the following amendments deserve attention: a) judicial rehabilitation; b) preference in payments of credits with secured guarantees in relation to tax credits; c) compromising bankruptcy regulations with rules related to the execution of financial assets deposited in clearing houses and with the rules that govern the compensation and liquidation agreements entered into between financial institutions and companies (netting agreements).

The purpose of judicial rehabilitation is the recovery of companies that are in temporary financial difficulty. In this respect, the bill makes available to both creditors and debtors a broad list of instruments meant to facilitate the renegotiation of debts, allowing them to renegotiate debts and contract new loans simultaneously, which will serve as an incentive for previous creditors to extend deadlines and special payment conditions. The credits resulting from loans and financings granted during the period of judicial rehabilitation will have preference even over labor credits, in the event judicial rehabilitation is converted into bankruptcy by a court order. Creditors may, in addition, supervise the activities of managers of the company, as well as approve, change or reject the judicial rehabilitation plans.

During the bankruptcy procedure, the credits backed by secured guarantees shall have payment preference over tax credits. Such amendment – since tax credits are currently paid before credits with secured guarantees – will reflect on financial transactions in a positive way, as secured guarantees are often an imposition of banking practices. In addition, we point out that with respect to

payment preference, the referred to amendment is not an isolated creation of the Brazilian legislator. On the contrary, the credits with secured guarantees are preferred over tax credits in countries like Belgium, Sweden and Russia. In the United States, Portugal and China, the credits with secured guarantees are preferred in connection with tax and even labor credits.

The new law, accordant with the legislation in force, establishes that the financial assets, goods and rights deposited with clearinghouses in the fixed or variable income markets should be liquidated according to the rules contained in the regulations of each clearinghouse. In the event bankruptcy of an investor of the stock market is declared, it is understood that the investor's obligation toward the other party is to be paid and the financial assets deposited by the investor in the clearing house are to be duly executed according to the operational rules of the house, as per Law no. 10,214/01 introduced due to the new payment system in Brazil.

In connection with financial transactions performed outside the scope of clearing houses, the text of the new bankruptcy bill answers any doubts with respect to the possibility of netting. If there is a compensation agreement, as per Resolution CMN no. 3,039/02, such agreement will be supported by article 119, item VIII of the bill. Therefore, in the case of a passive banking transaction with a certain company (such as time deposit) and such company is later declared bankrupt, the credit resulting from such transaction will not integrate the estate and may be compensated against a banking debt of the referred to company in the same amount and the maturity of such debt shall be accelerated. Despite the fact that compensation of financial transactions is already provided in the banking rules currently in force, supported also by the Civil Code and the current bankruptcy law, the Company Rehabilitation Law deals expressly with the subject in the scope of the national financial system.

Finally, some amendments to the Tax Code were also approved in order to avoid that the innovations in question, mainly with respect to credit classification, are not in disagreement with the referred to Code, which was accepted by the 1988 Constitution as a supplementary law and, therefore, in the event of conflict, it would prevail over the Company Rehabilitation Law (an ordinary law). According to the new wording of the Tax Code, credits with a secured guarantee shall have preference with respect to tax credits. In short, once the amendments described above are confirmed, certain legal concepts in financial and capital markets will be perfected and, consequently, there will be a boost in the granting of credits.

JUDICIAL EXECUTIONS: INNOVATIONS IN SIGHT PROMISE MORE SPEED AND EFFICIENCY

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On July 7th, the House of Representatives approved Bill no. 3,253/04, which, once approved by the Federal Senate and sanctioned by the President of the Republic, will contribute to a faster and more effective solution of judicial actions demanding payment of a specific amount.

According to the legal provisions currently in effect, after the already lengthy lawsuit through which a creditor has to go through to seek judicial acknowledgement of his or her credit, the creditor still has to file another lawsuit – an execution action – to force the debtor to pay the amount due.

In such case, the debtor may file a motion for declaratory judgment which suspends the course of the execution action and, consequently, further delays the payment of the credit, already acknowledged in court, since the execution procedure will only continue its normal course after the above mentioned motion has been decided.

According to the main amendments proposed, after a decision ordering the debtor to pay the given amount, the filing of another action will no longer be necessary in order to compel the debtor to comply with his or her obligation. It will be sufficient if the creditor – during the same action in which it was decided that he or she would receive the amount demanded – requests that the debtor be notified to pay the debt, which shall be increased by a fine of 10% in the event of non-compliance with the court order.

The appropriate measure to be used as a defense by the debtor will also undergo amendments: the motion for declaratory judgment – which shall now be called motion to deny – will, as a rule, no longer suspend the course of the execution action, which may then continue its course until the moment in which the subsequent phase to be reached is the payment of the specific amount due to the creditor.

This means that the creditor, while waiting for the motion for declaratory judgment to be decided, will no longer be prohibited from performing the acts required to receive payment of his or her credit. Hence, even during this phase it will be possible to request the moving forward of the execution action and the subsequent performance of the acts, the accomplishment of which are currently prohibited, such as the evaluation of the assets serving as a bond in the action, the auction of such assets and, even, their foreclosure, and the amount resulting from the sale shall remain deposited and at the court's disposal ready to be delivered to the creditor at the appropriate moment.

As one may notice, the conversion of the referred to bill into a law shall represent an important step towards creating a more rapid procedural system and, as a result, more effective, which shall collaborate to improve the operation of the Judicial Power and to lessen the damages caused by the delay in receiving credits.

TRUST: INCREASING ASSIMILATION BY BRAZILIAN LAW

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On August 2, 2004, Law no. 10,931 was sanctioned causing great repercussion in the real estate market. One of the most important innovations introduced by the Law is the perfection of the subject of the segregate estate in real estate developments, a matter that was appropriately examined by Christiane Scabell Höhn in the previous edition of the BM&A Review. All of the innovations commented on in her article, which was based on the final text of the Bill approved by Congress, were confirmed in the text sanctioned by President Lula.

The recently enacted law confirms the tendency to extend the application of segregate estates in our legal system and the increasing use, in a general manner, of the typical elements of a trust, which is a traditional instrument in Common Law countries.

The fiduciary transfer of an asset or right for a specific purpose, which in essence is what defines a trust, is provided in diverse and sparse laws, among which the following may be noted: Law no. 4,728/65 through article 66, amended by Decree-Law no. 911/69, deals with chattel mortgages as a guarantee for moveable assets; Law no. 6,404/76 by means of article 41, as amended by the 2001 revision, establishes the possibility of the custodian institution acquiring the fiduciary ownership of the fungible shares which were deposited therein; Law no. 8,668/93 governs real estate investment funds and Law no. 9,514/97 creates chattel mortgage in guarantee for real estate property and the fiduciary assignment of real estate credit rights. In addition, the fiduciary ownership of moveable assets, as a guarantee, was incorporated into the new Civil Code in article 1,361 and following, and now possesses a feature of being a general rule.

The segregate estate, in turn, essential for the viability and use of a trust, had also already been established in other special laws, among which is the referred to law which deals with real estate investment funds. It is important to highlight that since a segregate estate represents an exception to the principle that a debtor's current and future assets will be liable (article 591 of the Code of Civil Procedure), a segregate estate must result from an express legal provision.

Once the segregate estate is formed, the assets, rights and obligations which make up the estate, even though they formally integrate the estate of an individual or legal entity, remain legally separate from the others, as if "immobilized", receiving different legal treatment, since they have been segregated for a specific purpose. In this sense, the family asset, for example, could be considered as a type of segregate estate. But, the main objective of the institute, as occurs in Law no. 10,931/2004, is to protect the segregated assets from debts which have no relation thereto, making them immune to creditor's actions against the respective owner, as a benefit to third parties which, due to a contract, hold a certain right or interest in connection with those specific assets.

In most cases, however, the segregation of the estate, although necessarily created by a law, results from a fiduciary, legal or conventional relationship. Similarly, that is how it works, for example, in a trust or in a real estate investment fund. From this standpoint, the segregate estate is the external facet, the main consequence, valid erga omnis, of such relationship that is formed and developed between the fiduciary owner and the "effective" owner.

In Brazil, the fiduciary transaction is accepted and disseminated more than ever as a type of atypical contract. Actually, Bill no. 4,809/98 was drafted providing for the so-called "trust contract". Despite the discontinuance of the referred to bill in January 2003, for lack of procedural progress, it is a fact that today the difficulty perceived by legal scholars seems to have been overcome in the sense that they no longer find resemblance between such type of contract and a simulated transaction, since the fiduciary transfer of an asset would have no purpose in itself, but would only be a means to obtain the accomplishment of another transaction, usually a management or guarantee transaction.

Thus, one may notice the growing assimilation by Brazilian Law of the essential features of a trust, mainly fiduciary ownership and segregate estate, in response to an ever-growing demand for such type of contract. If, on one side, a trust cannot be imported by our legal system prêt-à-porter, on the other side, it is possible to reach similar results, using other means.

And despite the fact that fiduciary transactions and segregate estates are only applied in certain sectors in Brazil, for lack of a more wide-ranging and systematic regulation, as per the recent Trust Law in Uruguay – to make chattel mortgages viable for management purposes –, mainly our business practice has been searching for features of a trust more than ever, especially because of the protection it offers to an estate.

IS THE CONDOMINIUM AND REAL ESTATE DEVELOPMENT LAW IN FORCE?

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The real estate market had been co-existing with the Condominium and Real Estate Development Law – Law no. 4,591/64 – when in January 2003 the new Civil Code came into effect (NCC), bringing new rules in relation to condominiums. The new rules contained in the NCC gave rise to a doubt for which a consistent solution has not yet been found: what would happen to the former rules about condominiums, not contained in the revoked 1916 Civil Code, but in the Condominium and Real Estate Development Law (LCI), not expressly revoked by the new codification?

The interesting point of this issue is the fact that the NCC did not offer a response to diverse problems which were resolved by the LCI, such as the lessee being able to participate in general condominium meetings with voting rights whenever there were discussions regarding resolutions that affected ordinary expenses of the lessee's responsibility; the condominium manager's obligation to keep the condominium's accounting documents for a period of five years; the obligation to convene an advisory board; the obligation to incorporate a contingency fund, among others.

Legal scholars are divided into two opinions: for some, the NCC revoked the first part of the LCI (articles 1 through 27), which dealt with residential building condominiums, as it completely regulated the subject through articles 1,331 to 1,358, entitled "Residential Building Condominiums". For others, however, provisions of the LCI that deal with matters not provided in the NCC will still be in effect, due to the fact that a previous special law (LCI) cannot be revoked by a subsequent general law (NCC), except with respect to matters which are incompatible therewith.

Since the discussion is still recent, the courts do not have a definite position on the matter. In the legislative field, however, Bill no. 6,960/2002 is being registered and in the beginning of February it received a favorable opinion from the Constitution, Justice and Editing Committee of the House of Representatives and today it awaits a resolution from the Commission for Defense of Consumers specifically with respect to one of the amendments proposed in the Bill, having the Reporting Congressman delivered a favorable opinion in connection with the Bill; after the deliberation of the Commission, the Bill should be included on the trial docket for the Plenary session voting. Its wording is specific, pointing out the revocation of the first part of the LCI – which, in the end, does seem to have been the legislator's intention, in order to have only the provisions on real estate development in force.

The conclusion, however, that Law no. 4,591/64 would have been revoked in connection with the part about Residential Building Condominiums would involve leaving innumerable legal doubts, for which the NCC does not offer a solution today, without an answer.

The examination of such issues should be done on a case-by-case basis, it being reasonable to imagine that legal scholars and case law will search for solutions in the principles already established by the LCI.

It is the case, for instance, of the lessee's right to vote in general condominium meetings whenever the deliberation regards ordinary expenses. In fact, since the lessee is the one responsible for the payment, it is only fair that he or she be entitled to deliberate on the respective proposals. The same may be said with respect to the condominium manager's obligation to keep the condominium's accounting documents for five years: since the rule is tax related, there would be no reason, in principle, to exonerate the condominium manager from such an obligation.

It seems reasonable for us to predict that the parameters of the LCI, established even by practice, will remain socially effective in the solution of issues not regulated by the NCC.

Lastly, it is appropriate to note that the recent Law no. 10,931/2004 absorbed some criticisms from the real estate Market into the amendments provided by the NCC, making the rules more flexible in connection with the definition of a notional fraction of a property which is to be attributed to each unit, granting more freedom to the condominium occupants to amend the internal regulations of the condominium and to define the criteria of apportionment of the condominium's expenses. In addition, with respect to real estate developments, important amendments were provided by the LCI, especially in connection with the so-called "segregate estate", as already described in BM&A Review n° 5 (please see, also in this respect, the article by Henrique Vargas Beloch in this edition).

THE FEDERAL SUPREME COURT RENEWS ITS DISCUSSION ON THE INTANGIBILITY OF VESTED RIGHTS

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In a historical session, which took place on August 18, the Federal Supreme Court concluded the trials of Direct Actions of Unconstitutionality nos. 3,105 and 3,128 (“ADIs”), and, by a majority vote (seven to four), considered that the contribution by retired civil servants – introduced in the scope of the social security reform, by means of an amendment to the Federal Constitution – is, in fact, constitutional, exception made only to the unconstitutionality, in disrespect of the principle of isonomy, of the difference of rates for civil servants in the diverse states of the Federation.

The economic and political impact of the final decision tends to hide aspects which are as or more important, although less concrete and not very visible for now, revealed by the intense debate which preceded the decision. We refer specifically to the discussions that, in regard to this case and for the first time, were held about the concept of a fundamental clause (cláusula pétrea) and the possibility of having Congress interfere, through an amendment, in the hard core of the Constitution (article 60, paragraph 4, especially item IV).

Not only the result of the trial, but, mainly, some of the arguments used to justify the decision are suggestive of the profound changes in the Court’s profile, the composition of which substantially

changed in the last few months: four of the eleven Ministers that today make up the STF were appointed by the current Government.

Actually, until now few constitutional issues were as generally accepted as the limits on the derived constitutional powers in relation to the intangibility of the fundamental clauses – among which is the protection of vested rights, the core of the debate carried out due to the above mentioned ADIs. As publicized, the thesis being defended by Minister Joaquim Barbosa Gomes – the first to vote in favor of the constitutionality – is that the fundamental clauses do not define an absolute limit, but should be reflected upon beforehand on a case-by-case basis considering the other constitutionally established values, in such a way as to conform legal order to social evolution.

Such understanding towards the possibility of mitigating vested rights – despite that a fundamental clause is being dealt with – creates a new background for the ever controverted discussion about the application of new laws to already established legal relationships, such as contracts already being performed. From this particular standpoint, the precedent deserves special attention and its future projections will surely become news in this realm.

CVM ISSUES NEW INSTRUCTION ON INVESTMENT FUNDS

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After a long wait, on August 18 Instruction CVM no. 409 was published, providing new rules for securities investment funds. The main changes are: creation of diverse categories for funds; decrease in bureaucracy in the registration of products; in addition to the definition of civil liability between the manager and third parties – i.e., the fund managers – for possible problems in the management and administration of the portfolios. It is believed that the innovations in the regulations shall bring about more security and transparency to the fund industry, which makes choosing and following-up easier for the investor. Instruction CVM no. 409, however, will not apply to funds governed by their own regulations, such as equity investment funds, credit rights investment funds and real estate investment funds. The rule that revokes, among others, Instruction CVM no. 302, will come into effect 90 (ninety) days as of its publication, but the funds currently in operation will have until December 31, 2004 to adapt to the new rules. The amendments resulting from the new Instruction were detailed in BM&A News and Perspectives – Financial and Capital Markets no. 2/04 (www.bmalaw.com.br/pt/newsletter.asp) developed by the Banking department.

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EXECUTIVE EDITORIAL

BM&A Pesquisa

PRODUCTION
Tárcia Correa, Maria Eugênia Bías Fortes, FSB Comunicações

GRAPHIC DESIGN AND LAYOUT
Soter Design

PHOTOLITHO
Open Publish

PRINTED BY J. Sholna

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