

## BRAZIL'S NEW NATIONAL FEDERAL REVENUE SERVICE PRESENTS BOTH BENEFITS AND PROBLEMS

BARBOSA, MÜSSNICH & ARAGÃO

Specializes in the following areas of law:

Corporate Law

Restructuring

Tax Law

Banking

Stock Market

Project Finance

Litigation / Arbitration

Economic Law

Real Estate Law

Administrative Law

Privatizations & Concessions

Environmental Law

Labor and Social Security Law

Intellectual Property

Third Sector

Energy

**01**

Brazil's new national federal revenue service presents both benefits and problems

**02**

Alcohol and drug use prevention policies require careful implementation

**03**

Competition Liabilities Acquiring problems

**04**

The supreme federal court may break the postal service's monopoly

**05**

Securization: an opportunity for sports

**06**

New legislation relaxes the rules governing associations under the civil code

The new Federal Revenue Service of Brazil, better known as "Super Revenue", began functioning on August 1, 2005. Created under Provisional Measure (PM) 258, Super Revenue is the legal embodiment of current practice: social security contributions are now collected by the Federal Revenue Service, and the former Social Security Revenue Service is extinguished.

Although the new department will be more efficient in the collection of taxes and contributions and the resolution of administrative proceedings, and will make the decisions of the Taxpayers' Council (Brazil's administrative tax appeal board) more consistent, Gabriel Lacerda Troianelli, one of Barbosa, Müssnich & Aragão's tax partners, foresees problems in implementing the new system that could cause real losses to companies. The early stages of implementation are likely to see some difficulties with obtaining tax certificates, as well as delays in processing and deciding administrative appeals, for example. Some complications can also be expected in the set-off of contributions that formerly came under the administration of the National Social Security Institute against taxes and other contributions traditionally administered by the Federal Revenue Service (FRS).

Article 4 §3 of the PM excludes the set-off of taxes and contributions provided for under article 74 of Law 9430/96. In practice, Super-Revenue has full powers to determine the amount of federal tax and social security credits, but the PM prohibits set-off. Thus, one of the main advantages to companies arising out of the unification of the Social Security Revenue and the Federal Tax Services – set-off between taxes and contributions – will not occur. At present, it is possible to set off an overpaid or mistakenly paid tax, such as the Social Contribution on Net Profit (Contribuição Social sobre o Lucro Líquido – "CSLL") against amounts of corporate income tax falling due. "Now that Super-Revenue is responsible for receiving, assessing and administering all social security contributions, nothing should prevent cross-over set-off, between future corporate income tax and overpaid payroll contributions, for example. The legislation already allows the FRS to deny a tax refund if it determines that the taxpayer has a payroll tax debt, which amounts, in practice, to a 'cross-over set-off.' It's not reasonable to prevent taxpayers from doing the same thing," argues Troianelli. According to the tax specialist, the prohibition against set-off is an inconsistency that violates the constitutional principles of reasonability and equal treatment. The businesses that will most suffer from the inability to set-off social security contributions against other federal taxes are service companies that supply manpower, since payments to such companies are subject to an 11% withholding tax, which is applied to their social security contributions.

Where administrative tax proceedings are concerned, however, Troianelli believes that Super Revenue will be responsible for significant advances. Under the PM, the jurisdiction of the Social Security Appeals Council is transferred to the 2nd Taxpayers' Council of the Treasury. "With this change, we can expect decisions on tax questions at the administrative level to become more uniform, in an attempt to prevent certain issues from reaching the courts," says Troianelli. In this respect, Super Revenue will bring gains in synergies and the fight against tax evasion for the government and simplification and integration of information systems for the taxpayer. In fact, the prospects for improved administrative solutions to tax disputes are so good that Troianelli recently relocated to São Paulo to lead Barbosa, Müssnich & Aragão's new Administrative Litigation group.



## SPECIAL PANEL OF THE SUPERIOR COURT OF JUSTICE PROVES ATTACHMENT OF REVENUES

On June 29, the Special Panel of the Superior Court of Justice (SCJ), which is responsible for the uniformity of decisions issued by Brazil's highest court on non-constitutional matters, settled a question of fundamental importance to business firms: judicial attachment of revenues. The SCJ had issued conflicting decisions on whether attachment of revenues was possible. The First Panel had denied the possibility, on the grounds that it would amount to attachment of the entire business, which is legally impossible, while the Second and Fourth Panels had opted for a more literal reading of the law, provided that attachment of revenues would not impair the viability of the business. In fact, article 678 of the Code of Civil Procedure does contemplate attachment of a debtor company's revenues, and even provides for appointment of a depositary, who is required to submit the method for managing the attached revenues will be managed and paying the debt to the executing court. In the June 29th decision, the reporting Justice, Sálvio de Figueiredo Teixeira, held that attachment of up to 10% of a company's revenues is possible, where the other assets offered by the debtor are insufficient or ineffective to secure the debt under execution, and the attachment does not compromise the debtor company's solvency.

## ALCOHOL AND DRUG USE PREVENTION POLICIES REQUIRE CAREFUL IMPLEMENTATION

*Luiz Felipe Tenório da Veiga | lft@bmalaw.com.br*  
*Cibelle Linero | cml@bmalaw.com.br*

Consumption of alcohol and drugs, which occurs among people of all social classes and all levels of education, is one of the biggest public health problems in today's society. An important consequence of this social problem is its negative impact in the workplace, where alcohol and drug abuse can result in lack of concentration, poor quality, low productivity and, even more seriously, an increased risk of workplace accidents.

More and more companies are trying to reduce these problems by implementing policies to prevent the use of drugs and alcohol. The policies seek to identify the existence of users, their level of dependency, and the degree to which their dependency interferes with their job performance or presents risks to other employees and the company, and to assist affected employees through special treatment programs.

Although the adoption of drug and alcohol use prevention programs by private employers is aligned with public health programs and modern notions of corporate responsibility, Brazilian legislation on the matter is sparse. Law 6368/76 contains no more than a general provision regarding the employer's obligation to cooperate in the prevention and suppression of illegal drug trafficking and unlawful use of narcotics in the workplace. The only regulation dealing with alcohol and drug use in the work environment is Joint Administrative Order 10/2003, by which the Ministry of Labor and Employment issued a recommendation that companies promote activities to educate and inform employees about the problems associated with the use of narcotic substances at work.

Due to the lack of specific legislation on workplace drug and alcohol use prevention programs, there is some question as to whether programs that are not simply informational, but involve, for example, medical exams to detect actual consumption of drugs and alcohol by employees, would violate workers' right to privacy, particularly in view of Brazil's protectionist labor laws.

Although debate on the question of employees' right to privacy is intense, the trend is to accept that prevention programs do not represent an invasion of workers' privacy, provided that certain precautions are taken, such as voluntary adherence to the program, express consent by the employees to medical examinations and confidentiality of medical information.

In summary, workplace drug and alcohol use prevention programs, if developed and implemented with due respect for employees' privacy, are not only consistent with the principles of Brazilian labor law, but should be seen as an investment in social action that will benefit both employees and employers.

## COMPETITION LIABILITIES: ACQUIRING PROBLEMS

*Ivo Teixeira Gico Junior | itg@bmalaw.com.br*  
*José Carlos da Matta Berardo | jcm@bmalaw.com.br*

In July, Brazil's Administrative Council for Economic Defense (CADE) found the Gravel Mining Industrial Association of the State of São Paulo (Sindipedras), together with 18 other mining and gravel companies operating in the São Paulo metropolitan area, guilty of forming a cartel to divide the market. According to the authorities, the cartel's objective was to increase prices to consumers and defraud the public bidding process for government contracts.

CADE's decision broke new ground on several fronts. It is the first time that a cartel has been effectively sanctioned through the use of police-style investigatory techniques. The Federal Advocate-General's Office, the Federal Attorney-General's Office and the Federal Police carried out a search and seizure at Sindipedras' headquarters. The documents seized were used by Economic Law Secretariat (SDE) to support its case against the gravel companies. The decision also marks the largest fine imposed by CADE in the 11 years that Law 8884/94 has been in effect: 20% of the gross revenues of the companies who in any way actively colluded in organizing the cartel.

One of the most significant aspects of the decision, however, has received little attention: control of one of the mining companies found guilty of forming a cartel had been recently transferred to a new shareholder, and no evidence was produced to suggest that the company continued to participate in the cartel after the transfer of control. The company's attorneys promptly brought these facts to CADE's attention, arguing that the company and, ultimately, its new shareholders, should not be held liable for the alleged illegal conduct of the former shareholders. In response, CADE emphasized that the penalty was being imposed on the legal entity responsible for the conduct and not on its shareholders, and maintained the fine. In its decision, CADE went so far as to suggest that if the purchasers felt they had been injured, they should bring an action for damages in the ordinary courts.

CADE's stern position serves as a warning to attorneys and other professionals working in the area of mergers and acquisitions: if in mid-1995 the Kolynos-Colgate case gave special status to the requirement for CADE's approval of acquisitions, 10 years later it is clear that competition issues can affect the valuation of the acquired assets, if they are encumbered with competition liabilities.

Until recently, this type of liability was often underestimated or even ignored by potential buyers, due to the low probability that competition issues could turn into real problems. In addition, some companies did not

monitor potential competition problems or even on-going investigations by competition authorities. With increased investigation into anti-competitive conduct and the growing number of fines imposed by CADE, this attitude is becoming ever more dangerous. After all, a fine of 30% of gross revenues can easily wipe out any gain from an acquisition. Competition liabilities have therefore become important enough to affect the valuation of significant assets, in light of the potential and cumulative civil liabilities provided for under the legislation.

As with any other type of liability, there are a few basic ways of dealing with competition contingencies. The first step is to identify points of concern and provide for adjustments to the price based on the possible outcome of contingency, or even discount the liability directly in the final price. Another option, which can be used instead of or along with adjustments to the price, is to include provisions in the acquisition agreement that allocate responsibility for competition liabilities, and establish indemnities in the event of loss resulting from prior anticompetitive conduct. Other measures, such as financial safeguards to provide security for non-identified or unquantifiable contingencies, can also be negotiated by the parties.

Competition liabilities can be identified prior to the acquisition through a careful legal due diligence, which should review not only on-going investigations, but also the commercial practices adopted by the selling shareholders. In this context, the existence of an effective program for quality and control of commercial practices – in other words, a compliance program – can generate a significant premium in the price of the assets to be sold, since such programs reduce uncertainty as to the existence of competition liabilities, which in turn diminishes potential risks and their impact on the assets' price.

Nevertheless, even companies that keep a close eye on their business practices can have very sizeable competition liabilities, especially when they operate in international markets and do not have complete control over their activities in Brazil. Furthermore, many of the investigations now in course are confidential, which makes it impossible to quantify potential liabilities precisely. The solution to these uncertainties is to include liability provisions in the acquisition agreement, arrange for financial shielding, or negotiate other structures appropriate to each case. One thing remains certain, however: the precautions suggested above can make the difference between a good deal and a bad one.

## THE SUPREME FEDERAL COURT MAY BREAK THE POSTAL SERVICE'S MONOPOLY

Álvaro A. de F. C. Palma de Jorge | [aaj@bmalaw.com.br](mailto:aaj@bmalaw.com.br)  
 Luís Sérgio Mamari Filho | [lsm@bmalaw.com.br](mailto:lsm@bmalaw.com.br)

The monopoly held by the Brazilian Post and Telegraph Company (Empresa Brasileira de Correios e Telégrafos) over postal services in the country is under discussion in the Supreme Federal Court (SFC). The Brazilian Association of Distribution Companies (Abraed) has referred a constitutional question to the SFC, asking it to determine whether certain articles of Law 6538/78 (the Postal Services Law), which establishes a state monopoly over postal services, were received under the Federal Constitution of 1998. In the Brazilian legal system, reception is the legal mechanism by which the compatibility between a former law and a new constitution is determined. Non-reception occurs where the law is constitutional under the old constitution, but is incompatible with the new.

It is the SFC that has jurisdiction to decide cases of this nature. Brazil's constitution provides for a specific legal measure, the Reference on Violation of a Fundamental Principle (Reference), to avoid or repair injury resulting from the executive government's violation of a fundamental principle. National professional associations, confederations representing employee unions or employer associations and a number of other parties named in the Constitution have standing to bring a Reference. The SFC's decision on a Reference, which cannot be appealed, has effect throughout the country and binds all government agencies and departments.

Article 2 of the Postal Services Law provides that postal and telegram services shall be provided by the federal government, through a state-owned company under the responsibility of the Ministry of Communications. Under article 9 of the Law, the federal government has a monopoly over receiving, transporting and delivering letters and post cards within Brazilian territory, and over sending such correspondence to foreign destinations.

Abraed's challenge is based on article 1 (IV) of the Federal Constitution, which elevates free enterprise to the status of a fundamental principle of a Democratic State of Law. The association also argues that Law 6538/78 offends article 5 (XIII) of the Constitution because it impairs the right to work and the free exercise of office or profession. In addition, according to Abraed, the postal service monopoly violates article 170 (IV) (sole paragraph) of the 1988 Constitution. Lastly, Abraed argues that the only monopolies permitted in Brazil are those listed under article 177 of the Constitution, and the postal services are not mentioned in that provision.

Abraed also points out that distribution companies are constantly subjected to criminal and civil proceedings brought with a view to prevent them from carrying on their business. The courts have shown themselves to be ambivalent on the question of the state's monopoly, sometimes upholding it and sometimes denying it, which has created a situation of unacceptable legal insecurity. The association adds that article 21 (X) of the Federal Constitution merely requires the federal government to maintain a national postal service

and airmail service, which does not necessarily imply that it has a monopoly over these activities.

The Constitution requires that the Office of the Federal Advocate-General and the Attorney-General's Office be heard under the Reference. The Advocate-General took the position that the postal service is a matter of public order coming under the jurisdiction of the federal government, although the service may be performed by private parties through the grant of concessions or licenses, pursuant to article 175 of the Federal Constitution. The Attorney-General's Office agreed, concluding that the Postal Services Law was received under the current constitution. The SFC also heard a number of *amici curiae*, in view of the importance of the issue and the interest of the parties submitting briefs: the Brazilian Association of International Transportation Companies (Abraec) and the National Association of Express Delivery Companies.

Justice Marco Aurélio Mello, who is the reporting judge in the case, found that the Postal Services Law was not received under the 1988 Federal Constitution. He affirmed that, in some situations, the State's withdrawal from certain economic activities is consistent with the public interest. According to Justice Mello, maintaining the monopoly would violate the principles of free enterprise and freedom in the exercise of any economic activity. He also argued that the possibility of a dual regime for provision of services was introduced into the Brazilian legal system with Law 9472/97, which established the co-existence of a public and a private regime for telecommunications services. The reporting justice recalled that the debate over the abolition of the postal services monopoly is not a new one: in 1994, at the time the constitution was being reviewed, Justice Nelson Jobim, who was then a federal representative, had raised the need to extinguish the monopoly and end the Brazilian Post and Telegraph Company's hold over the market.

Justice Eros Grau, whose written opinion has not yet been published, disagreed with the reporting justice and voted in favor of maintaining the Brazilian Post and Telegraph Company's monopoly. According to Justice Grau, the postal services cannot be characterized as an economic activity and, as a result, Abraed's arguments are unfounded. Although the Justice believes that monopoly is not the correct term, nonetheless the postal service is a prerogative of the federal government, which is not inconsistent with exclusivity.

Judgment of the Reference was suspended when Justice Joaquim Barbosa asked to review the record, but a decision should be issued within the next few months. The question of the government's postal services monopoly is any extremely important one in this era of globalization. It is to be hoped that the other members of the SFC, when deciding the Reference, take into consideration Brazil's position in the global economy, as well as technological advances, consolidated practice in the sector and the geographical characteristics of the country.

# SECURITIZATION: AN OPPORTUNITY FOR SPORTS

Felipe Portugal | [fpl@bmalaw.com.br](mailto:fpl@bmalaw.com.br)

Securitization consists in issuing debt instruments or other securities backed by receivables, usually long-term, which are evaluated according to their risk. The principal objective of securitization is to enable the creditor of the receivables (whether an individual or a legal entity) to raise funds that are needed before the receivables are due, without affecting its credit limit with its own creditors and under its commercial contracts, nor increasing the indices of indebtedness on its balance sheet. Although relatively recent in Brazil, securitization of receivables has performed an important role in the United States' economy, where trading of securities backed by real estate receivables moves amounts in the order of 60% of the GDP, while in Brazil they represent a mere 1%.

Traditionally, securitization involves incorporating a Special Purpose Vehicle (SPV) to acquire the receivables of the creditor company and subsequently to issue securities backed by the receivables. With this structure, the SPV is able to pay much lower interest to investors and obtain greater market liquidity for its paper. It is also possible to use Receivables Investment Funds (Fundos de Investimento em Direitos Creditórios - FIDCs) as a vehicle for securitization. The FIDC, which was created by National Monetary Council Resolution 2907 of November 29, 2001 and is regulated by Instruction 393/03 issued by the Brazilian Securities Commission, is the instrument that the market needed to establish securitization as an efficient means of raising funds. Prior to FIDCs, the high costs, especially tax cost, of incorporating an SPV to securitize receivables were often prohibitive. Today, FIDCs are an important, and growing, securitization vehicle.

In sports, securitization has been used, mostly in the United States, to obtain financing for the construction of stadiums, such as the Staples Center, the MCI Center, the Pepsi Center and the Oakland Raiders Coliseum. Financing for the Pepsi Center in Denver involved a transaction that raised US\$139.8 million through a 20-year securitization of receivables from executive viewing boxes, future sponsorships and naming rights.

In November 2001, Fifa securitized its rights in the 2002 World Cup, held in Korea. The issued was backed by the sale of Fifa's marketing rights in the competition, and raised US\$420 million. Along the same line, the New York Islanders hockey team used its future revenue from broadcasting contracts with cable networks and advertising at home games to raise US\$200 million.

In Brazil, the sports industry grew 12.2% from 1996 to 2000, and today is one of the world's largest, employing 300,000 people and generating US\$16.2 billion a year in business, which is equivalent to 3.2% of Brazil's GDP. In economic terms, Brazil's sports industry is on a par with its petrochemical sector. The amount paid for rights to broadcast the Brazil Soccer Championship went from US\$55 million in 1998 to US\$88 million in 2003. US\$860 million was paid for exclusive rights to broadcast the 2002 and 2006 World Cups. In 2002, investment in sports sponsorships totalled R\$328 million, more than half of all investment made by Brazilian companies in the sector. For clubs and other sports organizations, therefore, securitization represents an opportunity to find financing for construction of stadiums, purchase of equipment and investment in their teams, or simply to improve their cash flow, based on admissions, broadcasting rights and image rights for future sporting events.

Brazil's legal system can accommodate esoteric asset-backed securities, or the securitization of unusual types of receivables. Through an issue of esoteric asset-backed securities, DW Funding LLC, a fund owned by Steven Spielberg's DreamWorks Studio, raised US\$1 billion in the United States market with securities backed by the studio's share in box office receipts for films such as *Gladiator*, *Minority Report*, *American Beauty*, *A Beautiful Mind* and *Road to Perdition*. In the U.S., the market for esoteric asset-backed securities, which first appeared about 10 years ago, represents some US\$350 billion a year.

Even individual athletes can consider securitizing their assets. In the 1990s, the English singer David Bowie used his royalties from compositions and records to back an issue of securities, in an innovative transaction that opened the way to "securitizing" natural persons. It is possible to imagine, for example, a securitization transaction in which an athlete would use his or her image rights to back an issue of securities, with risks measured by the same actuarial methods used by insurance companies to calculate risks and establish premiums. The securities could be put on the market through private placements or even, in a not-too-distant future, through public offerings.

## NEW LEGISLATION RELAXES THE RULES GOVERNING ASSOCIATIONS UNDER THE CIVIL CODE

Laura Fragomeni | lfo@bmalaw.com.br  
Paula Mena Barreto | pmb@bmalaw.com.br

Law 11,127/2005 has made substantial changes to the provisions of the Civil Code (Law 10,406/2002) that deal with associations, introducing greater flexibility and giving associations greater freedom to establish their own rules.

The Civil Code of 2002 had imposed a series of limitations regarding the functioning and management of associations, which resulted in innumerable operational problems. One of the most criticized provisions was art. 59. Under that provision, amendment of an association's corporate statute and removal of its elected officers and directors required the favorable vote of two-thirds of the members present at an assembly called especially to consider the question, with a quorum of at least one-third of the association's members. This rule made it impossible for associations with a large number of members to obtain approval for certain matters, since they could not reach the quorum required under the Code. Law 11,127/2005 has amended the Code to provide that the quorum will be established in the association's corporate statute, so that each association can now establish rules that reflect the reality of its membership and operations.

Another significant change is that while the Code gave the general assembly of members exclusive powers to elect officers and directors and to approve accounts, under Law 11,127/2005, other corporate organs can now decide these matters. In addition, the new legislation provides that an association's corporate statute must set out the manner in which the association will be administered and its accounts approved, on pain of nullity of the entire statute.

Law 11,127/2005 has also changed the procedure for excluding members from associations, to ensure that just cause for exclusion is established through a formal process that guarantees members the right to defend themselves and a right to appeal. Formerly, a majority of those present at a general assembly could decide to exclude a member, provided serious reasons for exclusion existed, with the excluded member having a right of appeal to the assembly itself. Now, members can be excluded only through a formal procedure set out in the corporate statute of the association.

The purpose of Law 11,127/2005 is to ease the overrigid rules originally established under the Civil Code of 2002 so as to give associations and their members a broader field of action and bring the law closer to the constitutional ideal of minimal state intervention in associations. To reduce problems with the transition to the new rules governing associations, the deadline for adapting corporate statutes to the Civil Code, as amended, was again extended, this time to January 11, 2007.

### PROJECT TEAM

#### EDITORIAL COMMITTEE

Paulo Cezar Aragão, Francisco  
Antunes Maciel Müssnich,  
Plínio Simões Barbosa.

#### EXECUTIVE EDITORIAL

BM&A Pesquisa  
Daniela Christovão

#### PRODUCTION

Taciana Correia  
Ana Christina Marques

#### GRAPHIC DESIGN AND LAYOUT

Soter Design

#### PHOTOLITHO

Davanzzo

#### PRINTED BY J. Sholna

This publication may not be reproduced in whole or in part without prior authorization by Barbosa, Müssnich & Aragão Advogados.

[bmareview@bmalaw.com.br](mailto:bmareview@bmalaw.com.br)

O BM&AReview® is published for informational purposes only and should not be relied on as legal advice for specific transactions or operations.

#### RIO DE JANEIRO

Av. Almirante Barroso, 52  
32º andar CEP 20031-000  
TEL. (+55) (21) 3824 5800  
FAX. (+55) (21) 2262 5536

#### SÃO PAULO

Av. Presidente Juscelino  
Kubitschek, 50 - 4º andar  
CEP 04543-000  
TEL. (+55) (11) 3365 4600  
FAX. (+55) (11) 3365-4597

#### BRASÍLIA

Setor Comercial Sul,  
Quadra 1 Bl.F nº 30 - 7º andar  
Edifício Camargo Correa  
CEP 70397-900  
TEL. (+55) (61) 3218-0300  
FAX. (+55) (61) 3218-0318

