

## ARBITRATION: NEWS AND OUTLOOK

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01

ARBITRATION:  
NEWS AND OUTLOOK

Companies are increasingly resorting to arbitration to settle disputes. The ratification of the New York Convention on the recognition and enforcement of foreign arbitral awards, enacted in Brazil by decree 4.311/2002, plus the weathering of the initial resistance against the system established by law 9.307/96 – the legal constitutionality of which was under judicial consideration for five years – have meant more and more companies resorting to arbitration in Brazil. The unanimous decision recently made by the São Paulo court (Bill of Review 285.411-4/0) is symbolic within this context. After analyzing a case which was trying to get a foreign arbitral award overturned, the court declared it was not within its jurisdiction to grant such a claim, adding that such jurisdiction is held by the court in the country in which the arbitral award was made.

02

SOLVING  
ENVIRONMENTAL  
LIABILITIES BY  
DECLARING  
INFRINGEMENTS AND  
EXECUTING AN  
ADJUSTMENT OF  
CONDUCT ACCORD

The growth in the number of arbitration courts has been accompanied by a similar growth in interest in the arbitration process from the legal profession itself. This is best exemplified by the Sao Paulo OAB's decision last August to approve the decision which regulates the Mediation, Conciliation and Arbitration Tribunal of the Commission of Legal Firms, which is intended to resolve disputes between legal firms and their members.

03

FOREIGN INVESTMENT  
IN BRAZIL THROUGH  
THE REALLOCATION OF  
RESOURCES

Within the context of these legal breakthroughs, the potential impact is being discussed of the Supreme Court's decision (STF) concerning the proceedings claiming unconstitutionality (ADIN 3003) proposed by the Federal Council of the OAB. These proceedings are targeting art. 30-F of Law 4.591/64 (added by Provisional Measure 2.221/2001), which establishes mandatory arbitration to settle disputes arising out of real estate acquisition agreements. The OAB is essentially arguing that legally imposing arbitration on parties in order to settle disputes is a violation of the principle of unrestricted access to the judiciary (art. 5, XXXV of the Federal Constitution).

04

ECONOMIC GROWTH  
AND ANTI-TRUST

Those individuals who are all for arbitration but have a pessimistic outlook fear that should the STF rule that mandatory arbitration is unconstitutional, the process of arbitration itself shall be affected, and not just the mandatory aspect targeted by the aforementioned proceedings. Those with a more optimistic outlook believe, to the contrary, that if a ruling is made declaring mandatory arbitration to be unconstitutional, this would strengthen the arbitration process according to the provisions established by Law 9.307/96, i.e. this process is a means of settling conflicts to be voluntarily elected by the parties.

05

THE ISS TAX AND  
COMPLEMENTARY LAW  
116/03

The fact is, regardless of the decision made by the STF, such decisions usually have repercussions on other legal decisions which recommend disputes be settled by arbitration. This is clearly the case of Law 9.478/97, which establishes as an "underlying clause" of oil and natural gas exploration and production agreements "the rules for settling disputes concerning the agreement and its execution, including conciliation and international arbitration" (art. 43, X), as is the case of the Wholesale Electricity Market (MAE) Law which binds the parties concerned to arbitration (art. 2, paragraph 3 of Law 10.433/02). Other cases, in which the mandatory nature of the directives under discussion may also be affected, could also be affected by the STF's decision .

06

REFORMING THE  
REGULATORY  
AGENCIES  
COMPANIES SET UP BY  
MARRIED COUPLES  
AND THE NEW CIVIL  
CODE

This is the case of the companies wishing to attain Level 2 Corporate Governance and to join the New Bovespa Market, which are obliged to submit any disputes to the Market Arbitration Board, whose decision is final. Another case which is also related to the settling of company disputes is established in the recently issued CVM instruction 391/03 addressing the creation, operation and management of Share Investment Funds which obliges the closely held companies in which the funds invest to abide by arbitration (art. 2, paragraph 4, IV).

# SOLVING ENVIRONMENTAL LIABILITIES BY DECLARING INFRINGEMENTS AND EXECUTING AN ADJUSTMENT OF CONDUCT ACCORD

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There are a number of companies in Brazil which possess contaminated areas both inside and outside company land. Much of this contamination has been caused not by current business practices but by procedures used in the past, when less importance was attached to matters of an environmental nature. These environmental liabilities may be caused accidentally or may be acquired by companies following mergers, acquisitions and incorporations. The fact is these liabilities must be resolved, given that these areas are a constant concern to state environmental agencies. This problem has been illustrated by the publication in early October 2003 by CETESB (the Environmental Sanitation Company) - an environmental agency in the State of São Paulo - of an up-to-date list of all the contaminated regions in the State, which contains 727 entries. In light of this situation, an increasing number of companies are using the recourse of informing the agencies themselves of the infringements committed, and then proceeding sign an adjustment of conduct accord (TAC – an agreement whereby the offending company and the agency establish the measures and term by which said company shall rectify/mitigate the environmental liability).

This entails companies voluntarily coming forward and informing the environmental agency and/or Government Attorney's Office of an environment liability, so that a solution to the problem can be found in conjunction with these agencies.

However, before coming forward, companies must take a number of precautions. These include checking whether all operating licenses are valid, whether any specific requirements have been fully fulfilled, and whether the obligations undertaken with the environmental agencies have been duly fulfilled, in addition to a series of other important aspects related to employee health and safety regulations. Alongside these meticulous checks, companies must also perform a technical-environmental audit in order to obtain further in-depth information regarding the contaminated area, including the area type, size, and associated risks and the technologies available to rectify and/or mitigate the damage.

Companies must also establish whether the contamination has seeped outside company land, in addition to ascertaining whether the public are at risk of exposure. This information is vitally important to help companies define which authority they should approach, and in deciding whether the public should be informed of the problem.

Once the steps above have been performed and the company has informed the agencies of the infringement, the company may propose to execute a TAC, and sit down and negotiate the terms and conditions thereof with the authorities involved in the case.

The TAC is an accord which the company executes with the agency to which it declared the infringement, and has the same legal powers of an extrajudicial execution instrument. This means that should the agreement not be fully performed, the aggrieved party may request the courts legally demand the full performance of the agreement. The TAC shall establish the means and the term by which the rectification or mitigation measures are to be fulfilled, in addition to the size of the fine to be applied in the event of non-performance or delay.

We have observed that companies which have come forward have been well treated by environmental protection agencies, which have been as lenient as the law allows them to be, in light of the proactive approach adopted by those companies making public their environmental liabilities. On the other hand, companies whose environmental liabilities have been discovered by the authorities themselves are not usually afforded the same degree of leniency.

However, it must be stated that there is some risk attached to declaring infringements, as this does not necessarily exempt the company from other forms of liability for causing damage to the environment, most notably criminal liability. Yet coming forward is an excellent way of reducing this liability, and also enables companies to enjoy closer, more transparent dealings with the environmental agencies and any members of the public affected, thereby speeding up the process of resolving the environmental liabilities.

The possible consequences facing companies coming forward should also be noted. This is because, in a number of cases, given the lack of specific regulations governing the issue, environmental agencies are pressured from outside, frequently without any legal-scientific basis, which compromises the progress and swift solution of the issue. Given this problem, a comprehensive set of regulations on the issue is highly important, so that agencies can act consistently and so that the real benefits on offer to companies coming forward can be established. All parties would benefit from such regulations: companies would have greater legal security and would therefore be more inclined to come forward; the public would enjoy more effective environmental protection and the environmental agencies would be in possession of clear rules to be followed in such cases, enabling them to act consistently throughout Brazil.

However, despite the lack of regulation, coming forward and declaring any infringements must be considered by companies as a feasible solution to their environmental liabilities, as this has generally proven to be a swift, straightforward and conclusive option.

# FOREIGN INVESTMENT IN BRAZIL THROUGH THE REALLOCATION OF RESOURCES

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The legal framework governing direct investments of foreign capital in Brazil is based around Law 4.131/62 which defines “foreign capital” as goods, machinery and equipment entering Brazil without any initial outlay, which is intended to be used in the production of goods or services. The definition also encompasses financial or monetary funds entering Brazil to be invested in business activities.

According to the long-standing position of the Central Bank, this definition established by art. 1 of the aforementioned law has restricted overseas investment in Brazil through operations which despite being legal according to corporate law, are not clearly permitted by the regulations of the Central Bank. As it was impossible to register operations with the Central Bank which were not explicitly established in art. 1, it was not possible to guarantee the remissibility and/or repatriation of the investments which such a register would have ensured its holders.

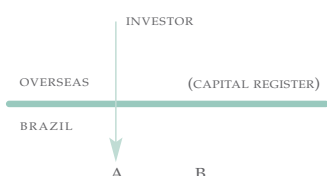
As part of the Central Bank’s policy, it has issued regulations which have made it somewhat easier to carry out the forms of overseas direct investment not explicitly established in the aforementioned article 1, but nevertheless included in the general concept.

The Central Bank has added a more comprehensive list of forms of direct foreign investment which could be registered, by means of Circular 2.997/00, which established the electronic, declaratory register of direct foreign investment, referred to as the “Module RDE-IED”.

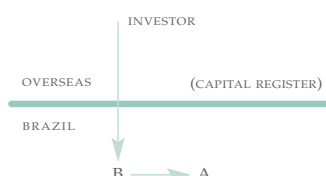
Amongst the possibilities for direct foreign investment established in the regulation of the Module RDE-IED, two means of reallocating funds which are already invested in Brazil (and registered with the Central Bank) have been increasingly employed by foreign investors, and entail: the transfer and exchange of shares or quotas.

The transfer of shares or quotas is an operation whereby foreign investors with a shareholding in, say, Brazilian company “A” acquire a shareholding in Brazilian company “B”, by transferring the shares or quotas held in A to the share capital of B. This kind of operation is considered to be relatively straightforward by companies. In this case, the register of the initial foreign investment is cancelled and the transfer of said investment to the new company is then registered.

Situation Before the Transfer

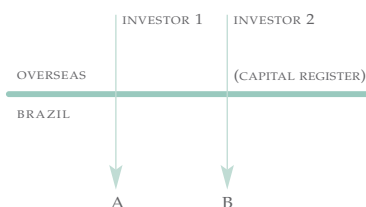


Situation After the Transfer

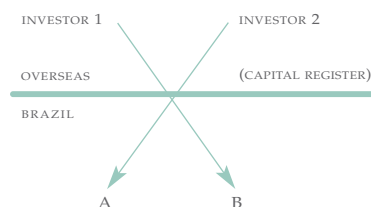


Exchanging shares or quotas is an operation whereby a swap is made between a foreign investor and a second investor, who may or may not be foreign, of the shareholdings they hold in Brazilian companies. The registers of the initial foreign investment are kept, with only the name of the investor being changed.

Situation Before the Exchange



Situation After the Exchange



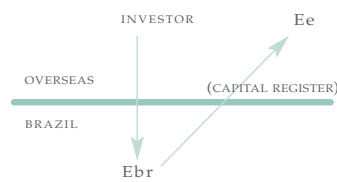
In addition to the option of direct investment involving the exchange or transfer of shares or quotas, foreign investors can also acquire a direct shareholding in Brazilian companies through the international transfer of shares. Unlike the transfer or exchange of shares or quotas, which as mentioned earlier enable foreign investors to directly invest in Brazil, the international transfer of shares involves Brazilian investment being made overseas, and is established in Chapter 7 (which regulates the floating exchange rate applied to Brazilian Overseas Investment, in accordance with Circular 3.037/01).

The international transfer of shares is an operation whereby investors residing overseas who have a shareholding in an overseas company (“Oc”) acquire a shareholding in a Brazilian company (“BrC”) by transferring the shares from Oc to the share capital of BrC. The investor residing overseas shall then have a shareholding in the Brazilian company (BrC), through the reallocation of the investment originally made in company Oc. In turn, the company BrC shall then have a shareholding in the overseas company Oc.

Situation Before the Transfer



Situation After the Transfer

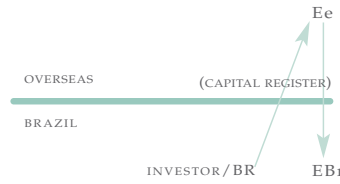


The international transfer of shares may alternatively involve an investor residing in Brazil ("Investor/Br") who has a shareholding in a Brazilian company ("BrC"), acquiring a shareholding in an overseas company ("Oc") by transferring the shares in BrC to the share capital of the company Oc. In this case, the investment originally made by the Brazilian investor in BrC is reallocated, and registered with the Central Bank.

Situation Before the Transfer



Situation After the Transfer



As the international transfer of shares involves Brazilian funds being invested overseas, any such investment is restricted to US\$ 5,000,000.00 (five million US dollars), or equivalent in other currencies, and must be made for at least 12 (twelve) months. Prior authorization must be obtained from the Central Bank for investments involving amounts above this ceiling.

Finally, it should be noted that the Central Bank regulations establish other means for acquiring shareholdings in Brazilian companies through the reallocation of investments. Examples of these include mergers, spin-offs and acquisitions of companies receiving direct foreign investment.

Nevertheless, as operations like the transfer and exchange of shares and quotas and the international transfer of shares are more straightforward, they have received more attention and as a result have been preferred by foreign investors looking to make investments in Brazil which can be registered with the Central Bank and do not involve the actual remittance of funds.

## ECONOMIC GROWTH AND ANTI-TRUST

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Now that the serious crisis of confidence which blighted the Brazilian economy in the second half of 2002 has been overcome, all signs indicate that the country could well undergo a new cycle of economic growth, which started in the last quarter of 2003 and could be sustainable this time around.

It is now therefore as good a time as any to reflect upon an important factor which shall differentiate this cycle from the other economic growth cycles witnessed in the past. This factor we are referring to is the structural changes which Brazil has been undergoing since the early 1990s, which have established a new pattern of State interference in the economy, which has had ramifications on the legal and business worlds.

An example of such structural change which has directly affected the business and legal worlds are the anti-trust policies initiated in 1994. Mainly dictated by the Economic Surveillance Secretariat of the Ministry of Finance, the Economic Law Secretariat of the Ministry of Justice and especially the Administrative Council of the Anti-trust Authority – CADE, occasionally operating jointly with regulatory agencies, the anti-trust policies shall play a key

role in this new cycle of economic growth. It is therefore essential that such agencies are in a position to tackle the challenges - at least in the area of activity where they is best known and have the most experience - which shall reinforce: the control of the structuring of the market by approving/disallowing the formation of monopolies (essentially mergers, acquisitions and associations between companies).

We believe that two of the main points of this challenge shall be the constant concern regarding predictability and legal reliability - which have a direct bearing on business decision-making - and the adoption of measures which could lower the costs, to both the public and private sectors, arising out of the analysis of operations which could create monopolies, by removing some of the red tape surrounding the procedure and making the agencies more efficient and faster when examining cases presented for their analysis.

It is hoped that the anti-trust agencies, who are aware of their responsibilities at this important time, can also do their part in lowering the microeconomic risk - maybe one of the main obstacles to economic growth - to the same degree to which the macroeconomic risk has been mitigated.



## REFORMING THE REGULATORY AGENCIES

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The Civil Cabinet of the Presidency of the Republic has recently put two draft laws before a public hearing, proposing changes to the roles of the regulatory agencies within the Brazilian institutional framework. These draft laws are being closely monitored by the Brazilian Congress, which has set up a Special Commission to do this. They are also being followed by the economic agents which are regulated and audited by the agencies, due to the fact that the changes being proposed are significant.

First of all, the government shall once again have the authority to grant public service concessions or licenses and to execute the respective agreements. One of the criticisms which has been leveled at this change is that this will enable politicians to have a say in any decision-making once again, thereby raising the level of uncertainty and the costs of investing in markets regulated by the agencies.

A second proposed change has also been received cautiously by the market which involves obliging the agencies to execute administration agreements with the Executive Branch. The government intends, through this legal instrument, to exert control over the provision of public services. The fact is, the agencies believe that this kind of agreement could transform into an actual means of exerting direct control by the Executive Branch over the regulatory agencies, which would make it easier for the Government to interfere in those agencies which it considers are not meeting their targets.

The final change being proposed is the creation of a Watchdog to be appointed by the President which would receive, investigate and settle complaints made against the agencies. If the original wording remains unchanged, the Watchdog would also have the authority to interfere in the decisions taken by the agencies, which would compromise the independence of any such decisions.

While the above proposals are being followed with apprehension by economic agents, a number of other provisions in the Draft Laws have been welcomed, including the provision which establishes the policy of holding public hearings prior to new regulatory proposals being made, the moves towards establishing a higher degree of professionalism of the staff, and the establishment of career plans for agencies, plus the explicit mention of interaction between agencies and Brazilian anti-trust authorities.

It is hoped that once the debates and input concerning the matter have reached a conclusion, these issues are developed in such a manner as to create a balanced draft, which meets the government's wishes of having a greater say in the granting of concessions and licenses for public services, without removing too much of the regulatory agencies' independence.

## COMPANIES SET UP BY MARRIED COUPLES AND THE NEW CIVIL CODE

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Article 977 of the 2002 Civil Code has been causing a great deal of controversy since the very day it was issued. This Article prohibits couples who have married in community of property or under mandatory separation from setting up companies together or with third parties. The outcry has been such that Bill 6.960/02 has been introduced which intends to remove this restriction, amongst other objectives. The DNRC has recently ruled that this prohibition does not apply in the case of companies incorporated before the Code came into effect. In some Brazilian states (Pernambuco and Rio Grande) there have already been lower court decisions authorizing the community of property status of marriages of businessmen to be changed in order to escape the effects of article 977. This is also a new provision established by the Code, by which article 1.639, paragraph 2 sets forth the possibility of changing the terms of marriage elected by the couple.

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