

## STF DECLARES UNCONSTITUTIONALITY OF PIS/COFINS ASSESSMENTS ON INCOME

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**01**

**STF declares Unconstitutionality  
of PIS/COFINS  
Assessments on Income**

**02**

**Trade Remedy proceedings in  
the U.S.: How Brazilian  
Exporters can overcome this  
Barrier**

**03**

**The new Anbid Code and the  
Rising Maturity Level of  
Brazilian Capital Market**

**04**

**CVM's Views on Securities  
Trading Via the  
Internet and/or Securities Issued  
and Traded Abroad**

**05**

**Appointment of a Member of the  
Board of Directors of Publicly-  
Held Companies by Non-  
Controlling Shareholders**

**06**

**Creation of Virtual Libraries  
Generates Disputes**

A decision by the Federal Supreme Court (STF) declaring the unconstitutionality of a law that has been in force since 1998 is expected to keep the courts busy during the year 2006. The court found against the Federal Government and accepted the pro-taxpayer arguments made on the records of Extraordinary Appeals Nos. 357.950, 390.840, 358.273 and 346.084, which challenged the constitutionality of the expansion of the calculation basis of PIS and Cofins instituted by Law No. 9718/98.

The constitutional basis for the contributions to PIS and Cofins was set forth in article 195, item I, of the Constitution, which established, in its original wording, that one of the funding sources of the Social Security was the social contribution levied on a company's earnings. Pursuant to Supplementary Laws Nos. 7/70 and 70/91, PIS and Cofins were levied on a company's earnings, which were defined as the net earnings resulting from sales of goods and services, which was in line with the constitutional foundation. Upon the enactment of Law No. 9718/98, the contributions were levied not only on the sales of goods and services, but also on all types of revenues earned by the legal entities, such as indemnifications, royalties, rents, interest...

During the trial, the justices concluded, by majority of vote, that paragraph 1 of article 3 of Law 9718/98 was unconstitutional. Such law had extended the legal concept of earnings, which thenceforth was defined as all earnings of legal entities, regardless of the type of activity performed by the company and the accounting classification applying to the revenues.

According to Sylvania Tognetti, a partner with the tax department of Barbosa, Müssnich & Aragão Advogados, the legal provision was rejected after a lengthy debate on the possibility of co-validation of such by Law by Constitutional Amendment No. 20/98, which brought about a new wording for item I of article 195 of the Constitution when it stated that revenues in general were potential calculation basis for the contributions. Therefore, it was decided that the concept of earnings for purposes of the assessment of PIS and Cofins corresponds to the net earnings resulting from sales of goods and services of any nature.

Sylvania advises that companies are able to discuss before the courts whether or not financial revenues or revenues resulting from lease agreements, for example, fall under such concept of earnings, and require the restitution/offsetting of amounts paid in that regard under the rule of Law No. 9718/98. "Please note that any such offsetting/restitution claim should cover only payments made before the date of effectiveness of Laws Nos. 10637/02 and 10833/03, which instituted, respectively, the non-cumulative system of payment of the Contributions to PIS and Cofins, beginning on March 2003, for PIS, and March 2004, for Cofins", she says.

The effects of the decision rendered by STF only benefits those companies that are parties to the extraordinary appeals that gave rise to such judgment. But, as per the constitutional provision, the Federal Supreme Court could inform the Senate of such decision, with the consequent suspension, by means of a resolution, of the part of the Law found to be unconstitutional, in which case it would affect everyone.

Meanwhile, interested companies may seek a court acknowledgement of the unconstitutionality of the extension of the calculation basis of said contributions and the consequent restitution/offsetting of amounts unduly paid before February 2003, in the case of PIS and February 2004, in the case of Cofins, subject to a five (5)-year statute of limitations (article 3 of Supplementary Law No. 118/2005).



*Sylvania Tognetti: tax department partner*

## TRADE REMEDY PROCEEDINGS IN THE U.S.: HOW BRAZILIAN EXPORTERS CAN OVERCOME THIS BARRIER

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In the United States (U.S.), trade remedy proceedings<sup>1</sup> make up a considerable hurdle for the access of Brazilian exports to the U.S. market. In fact, the application of trade remedy measures by the U.S.—often inconsistent with the norms of the World Trade Organization (WTO)—have been affecting, in the past several years, some sectors of the Brazilian industry.

Currently, 20 antidumping and/or countervailing duty orders against Brazilian exports are in force in the U.S. The steel industry is by far the most adversely affected, being the target of 18 of these orders in cases encompassing a range of products, such as carbon steel wire rod, hot-rolled carbon steel products, welded carbon steel plates and tubes, iron construction castings, amongst several others. Most of these orders have been in force for more than 10 years, while some have been in effect for over 20 years. In addition to the steel sector, exports of frozen and concentrated orange juice and frozen and canned shrimp from Brazil are also heavily burdened by antidumping duties in the U.S. In some cases, the duties imposed by U.S. authorities are so exorbitant that they simply banned certain Brazilian exporters from the U.S. market.

It should be noted that despite the insignificant share that Brazil's exports represent in the total U.S. imports (1.43% in 2004), Brazil is often a target of trade remedy measures. This is because Brazilian exports are highly competitive in sectors considered sensitive by Americans, such as the agricultural and steel sectors.

Some specialists assert that, indeed, trade remedy proceedings have turned into a powerful tool for “selective protectionism” in the U.S.<sup>2</sup> In several instances, U.S. authorities have taken advantage of the discretionary power granted by the WTO agreements. Such abusive practices, combined with the protectionist bias of U.S. trade remedy regulations, cause injurious effects to our exporters.

The so-called Byrd Amendment<sup>3</sup> is a good example. Under the Byrd Amendment, antidumping and countervailing duties collected on U.S. imports are distributed to U.S. companies that petitioned for those trade remedy orders.

This means that, when the U.S. industry requests a new trade remedy investigation, it envisions not only the possibility of curbing foreign competition, but also of receiving the duties to be collected by the U.S. Customs in connection with the trade remedy order. It is undisputable that the Byrd Amendment artificially encourages the request of new trade remedy cases in the U.S.

Other factors contributing to the difficulties faced by Brazilian exporters include: (i) the ease with which a trade remedy case can be initiated in the U.S. (requirements to file a petition are lax and have a subjective nature, and there is no efficient process for screening frivolous petitions); (ii) the practice of “zeroing” negative dumping margins adopted by the U.S. Department of Commerce (such practice—outlawed by the WTO<sup>4</sup>— allows U.S. authorities to artificially raise dumping margins when they exist and to make dumping determinations when there is no dumping); and (iii) the tendency towards perpetuation of trade remedy orders in the U.S. due to the distorted application of WTO rules by U.S. authorities in sunset reviews, amongst other factors.<sup>5</sup>

In light of these difficulties, it is important to point to alternatives for mitigating the U.S. “activism” in the application of trade remedy measures. One alternative would be to challenge such U.S. abusive practices before the WTO's Dispute Settlement Body. Even though it is a costly procedure, Brazil has been quite successful in dispute settlement proceedings before the WTO. Another alternative would be to promote greater engagement of the Brazilian industry in the trade remedy rules negotiations under the Doha Round. Although market access negotiations are always in the media's spotlight, it is necessary to emphasize the importance of achieving progress in negotiations on reforming WTO disciplines under the Agreement on Anti-dumping and the Agreement on Subsidies and Countervailing Measures. Unfortunately, the trade concessions negotiated during the Doha Round might be easily neutralized if the U.S. authorities continue to apply trade remedy rules in an abusive manner.

1. Trade remedy proceedings encompass antidumping duty, countervailing duty and safeguards proceedings.

2. “Selective protectionism” is an expression the Brazilian Embassy in Washington, DC has been using to describe the difficulties faced by Brazilian exporters of products regarded as sensitive in the U.S. market.

3. The Byrd Amendment was ruled inconsistent with certain WTO agreements under a panel initiated by Brazil and other countries in 2000. The U.S., however, has not yet implemented the WTO ruling due to opposition of the U.S. Congress.

4. The European Communities, India, and Canada have successfully challenged the practice of “zeroing” before the WTO. In November 2005, Ecuador requested formal WTO consultations with the U.S. to present a similar complaint against such practice.

5. For further details on these U.S. practices that have been affecting Brazilian exporters, see Aluísio de Lima-Campos, Nineteen Proposals to Curb Abuse in Antidumping and Countervailing Duty Procedures, *Journal of World Trade* 39(2), 2005. For a shortened version in Portuguese, see “Revista Brasileira de Comércio Exterior”, issue 82, pages 36-71, 2005.

## THE NEW ANBID CODE AND THE RISING MATURITY LEVEL OF BRAZILIAN CAPITAL MARKET

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With the recent coming into effect of the new Auto-Regulation Code of the National Association of Investment Banks (Anbid) relating to Public Offerings for the Underwriting and Acquisition of Securities (Anbid Code), it became clear how appropriate the initial release thereof was, back in 1998.

Most people remember that, beginning in 1997, the global markets faced one of its worst – and possibly longest – crises.

And it was exactly during that crisis, when some questioned the opportunity of the adoption of stricter rules than the ones that applied to public offerings of securities in Brazil, that Anbid had the initiative, with the support of the Securities Commission – CVM, to launch the Anbid Code, which established new standards of information to be included, mainly, in the offer prospectus relating to the institutions affiliated to Anbid (“Participating Institutions”).

Since then, we have undergone an adjustment and learning phase, which paved the way for the boom of operations that took place beginning on 2004, when the demand for capital market operations as an effective capital-raising and investment alternative converged with the verification that we have achieved improved levels of information disclosure, which are closer to the ones in force in countries with a vast tradition in terms of capital markets, such as the United States.

Please find below certain rules and recommendations that are part of the Anbid Code, which came into effect on November 1, 2005:

- Public offerings of securities (“POs”) and underwriting programs must abide by the rules that are part of the Anbid Code;

- Rules relating to the prospectus were amendment, with the definition that in cases of public offerings of promissory notes, when the prospectus is waived, a fact sheet must be disclosed;

- The inclusion of the Anbid Seal became mandatory in all publications subject to public access, as well as in prospectus and fact sheets;

- Analysis reports released by coordinators at the time of public offerings should be updated at least once every year:

- (a) until the maturity date, in cases involving securities representing debts, or
- (b) during the three (3) subsequent years in public offerings of shares.

- The Participating Institutions shall:

- » seek to adopt segregation procedures with regard to capital market activities;

- » carry out a due diligence procedure relating to the businesses and activities of the issuer to support the preparation of the prospectus and other documents relating to the public offering;

- » obtain a written document (“comfort letter”) from the independent auditors of the issuer and/or offering entities with regard to the consistency of the financial information included in the prospectus;

- » obtain a legal opinion from outside counsel with regard to the consistency of the information included in the prospectus;

- » accept responsibility for the fulfillment of the obligations of coordinators when acting as public offering coordinators, even if not as leaders;

- » describe potential conflicts of interests;

- » resort to arbitration, whenever possible, to settle disputes relating to the public offering;

- » in procedures of rescheduling of debt securities, include in the corresponding mandate the obligation of the issuer to update the prospectus;

- » motivate the hiring of an institution to develop market formation activities;

- » motivate issuers of shares, debentures convertible into shares or equity warrants to adopt the highest standards of corporate governance, with Bovespa’s Level 1 being the lowest admissible level in this type of transaction.

- Additional information to be included in the prospectus:

- » adoption – or lack thereof – of international standards of environmental protection by the issuer;

- » social responsibility, sponsorship and cultural incentive policies adopted by the issuer;

- » corporate governance practices recommended in the Code of Best Governance Practices issued by *Instituto Brasileiro de Governança Corporativa* (IBGC) adopted by the issuer and/or its parent companies;

- » in debenture offerings, the minimum quorum for resolutions of the debentureholder general meetings;

- » risk factors relating to the potential consequences of the lack of full placement of the securities, in a ‘best-efforts’ public offering; and

- » in cases of firm underwriting offerings, detailed information on the firm underwriting conditions.

As can be seen from the abovementioned changes that came into effect in November, public offerings of securities must seek higher standards of transparency with regard to the information made available to support investors’ decision-making processes. A stricter standard adopted by market players to ensure the transparency of such information will certainly contribute to the ongoing development and improvement of the Brazilian capital market.

## CVM'S VIEWS ON SECURITIES TRADING VIA THE INTERNET AND/OR SECURITIES ISSUED AND TRADED ABROAD

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The Securities Commission (CVM) enacted, on September 30, 2005, Guidance Directives Nos. 32 and 33 which deal, respectively, with the use of the Internet in offerings and intermediation of securities, and with offerings and intermediation of securities issued and accepted for trading in other jurisdictions.

Such Directives explained to the market the views of CVM with regard to (i) the characterization of a public offering of securities in Brazil, when the Internet is used as a means of communication and/or when the issuer is located abroad; and (ii) to the development of activities subject to the authorization of CVM via the Internet or in cases of intermediation activities of securities issued and traded abroad offered to investors that reside in Brazil.

Directive No. 32, CVM stresses that the use of the Internet for purposes of promoting securities usually represents a public offering, according to Law No. 6385/76 and CVM Ordinance No. 400/03. That is because the publication, via mass or electronic communication channels, for purposes of promoting the trading of securities, indicates the occurrence of the public underwriting thereof.

Public offerings via the Internet must be registered with CVM, but specific circumstances may uncharacterize the public nature of the offering, including: (a) an act by the sponsor of the web page to prevent the general public from accessing the contents thereof; (b) lack of divulgation to the public in general, by the corresponding sponsor, of the web page; and (c) clear indication that the web page is not aimed at the public in general. In any event, the characterization of the offer as a public one will always result from an analysis of the specific case. The use of the Internet for purposes of securities trading also requires approval by CVM.

With regard to the intermediation of securities issued and traded in other jurisdiction, CVM stresses that due to Law No. 6385/76, only the participants of the underwriting system registered with CVM can exercise such activity in Brazil. Authorizations to perform such services granted by a foreign regulating authority or resulting from foreign laws does not ensure the right to render such services in Brazil.

Foreign intermediaries that intend to offer securities issued abroad to Brazilian residents must register with CVM or hire a participant of the Brazilian underwriting system to conduct such intermediation.

However, CVM recognizes that the intermediation of securities issued and offered only abroad, involving investors who reside Brazil by foreign intermediaries is not irregular if the investors have been contacted abroad and the operation is not characterized as a public offering in Brazil.

According to Directive No. 33, an offering for the distribution of securities issued abroad is characterized as a public offering in Brazil when one of the communication means described in Law No. 6385/76 and in CVM Ordinance No. 400/03 is used for purposes of reaching the public in general, and the offering/offering company does not fall under one of the exceptions described in the CVM regulation. A public offering can be characterized, even if there is no intention to reach the public in general, when communication means that enable the access to the public in general are used and nothing is done to prevent such fact.

When evaluating distribution offerings involving securities issued abroad via the Internet, CVM will take the following elements into consideration in order to determine if the offering is aimed at investors residing in Brazil: (a) the existence of a clear and easily-accessible notice informing that the offering is aimed only at the specific countries where the sponsor of the web page or the issuer is authorized to deal; (b) actual actions of the sponsor of the web page to prevent the access of investors that are resident in Brazil to the contents thereof; (c) clear indication that the page was not created for investors residing in Brazil; and (d) lack of text, in Portuguese or otherwise, to attract investors that reside in Brazil. CVM can also take into account the use of the Portuguese language and the actual location of the Internet service provider.

Even though Guidance Directives Nos. 32 and 33 do not represent actual regulations, they point towards the standing of CVM with regard to the analysis of potential concrete cases involving the matters dealt with herein.

## APPOINTMENT OF A MEMBER OF THE BOARD OF DIRECTORS OF PUBLICLY-HELD COMPANIES BY NON-CONTROLLING SHAREHOLDERS

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Last June 15, when we took part of the extraordinary general meeting of a company representing shareholders who held common shares corresponding to approximately 12% of the corporate capital of such company, we faced a novel and peculiar situation with regard to the best interpretation of paragraphs 4 and 5 of article 141 of the Joint Stock Corporation Law (Law No. 6404/76), which lists procedures relating to the appointment, via separate vote, of a member of the board of directors of publicly-held companies by non-controlling shareholders.

In fact, paragraph 4, items I and II, respectively grants, to holders of common shares representing 15% of the corporate capital with voting privileges and to holders of preferred shares without voting privileges or with restricted voting privileges, representing 10% of the total corporate capital, the right to appoint one member of board of directors of publicly-held companies each. Paragraph 5, in turn, establishes that if the abovementioned quorums are not met by said groups of shareholders, “they shall be entitled to combine their shares and jointly appoint one member and the corresponding alternate for the board of directors, subject to the quorum described in item II of paragraph 4” (10% of the total corporate capital).

The controversy involved the rules set forth in paragraph 5. On the one hand, the majority shareholders concluded, based on a literal interpretation of the provision in question, that the application thereof would be conditional on two requirements: (i) division of the corporate capital of the company into common shares and preferred shares, and (ii) that the common and preferred shareholders attending the meeting actually combined their shares reaching at least 10% of the corporate capital. On the other hand, we believed that the proper interpretation of the provision in question was that if the position was not filled by the non-controlling shareholders pursuant to paragraph 4, the separate appointment could only take place by shareholders representing at least 10% of the total corporate capital of the company - either common or preferred - with no need to have their shares combined.

The Collegiate Body of the Securities Commission (CVM) then addressed the matter and adopted a standing that was favorable to our opinion on the matter, which resulted in an amendment of its prior standing, since it had approved two initial public offerings of publicly-held companies without preferred shares (Lojas

Renner S.A. and Natura Cosméticos S.A.) whose prospectus informed that the minimum shareholding to enable the appointment of members of the board of directors was 15% of the total corporate capital, according to item I, paragraph 4 of article 141, and not 10%, pursuant to paragraph 5 of the same article. Therefore, the Chairman of CVM, Mr. Marcelo Trindade, invoked item XII of the sole paragraph of article 2 of Law No. 9784/99, which prevents “the retroactive application of a new interpretation” of a Law in administrative procedures, concluding that the new interpretation and the effects thereof would apply only to future cases.

According to our standing, which was adopted by CVM in the abovementioned decision, the systematic and teleological interpretation of the legal provision in question should prevail over a merely literal interpretation. In that regard, we interpreted paragraph 5 of article 141 of the lei in such a way as to achieve the intention of lawmakers, via the amendment of the provisions of Law No. 10303/01 for purposes of broadening the participation of minority shareholders in the board of directors of companies. Therefore, if the positions of the board of directors are not filled by non-controlling common and preferred shareholders pursuant to the quorums established, respectively, in items I and II of paragraph 4 of article 141, there is no reason to deny the effectiveness of paragraph 5 in cases of companies that have only common shares or in cases where no combination of common and preferred shares exist, under penalty of preventing the representation of minority shareholders in boards of directors, which is against the reason that led lawmakers to amend the wording of article 141 during the latest reform of the Joint Stock Corporation Law.

Such decision was relevant because it is expected that, with the strengthening of the Brazilian capital market, an increased number of companies will issue shares to raise public investments, using the specific trade instruments created by the São Paulo Stock Exchange (Bovespa) which requires, for purposes of increasing activities and the liquidity of the shares, that companies meet certain rules of corporative governance in order to ensure a better treatment to non-controlling shareholders and that, in that regard, accept only common shares, such as, for example, the New Market. In such cases, a 10% - and no longer 15% - interest in the corporate capital is enough to enable non-controlling shareholders to appoint a member of the board of directors.

## CREATION OF VIRTUAL LIBRARIES GENERATES DISPUTES

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Major Internet companies, such as Google, Amazon, Microsoft and Yahoo, are beginning to invest in the rendering of services that may enable users to gain different degrees of access to actual virtual libraries. The common principle behind those initiatives is the digitalization of books, which will enable the access, via the Internet, to the contents of literary works.

Among the abovementioned companies, Google occupies an important position, since it intends to digitalize the entire collections of some of the greatest libraries in the world, – such as the libraries of the Oxford and Harvard Universities –, which would cause not only public-domain works but also works that are still protected by copyrights to become available on-line. According to Google, once the collections of a certain library have been digitalized, public-domain works will be made available immediately, since the legal term for doing so will have been met.

The reading of the full text of public-domain works will become possible, since the digitalization procedure causes the page made available to the user to be identical to the original book page. In addition to the contents of the work, the reader has access to bibliographic data and also other information, such as where to buy the book or how to find it in “real” libraries close to his location.

With regard to works that are still protected by Copyright, the Google project is divided into two segments. The company has been in contact with the holders of copyrights, generally publishers, such as Random House Mondadori – which are referred to project “partners –, for purposes of entering into agreements to make the works more accessible. The difference between this structure and the one involving public-domain books is that in the case of “partner’s” books only a few pages will be visible. With regard to books that are not part of such agreements, the reader will only have access to small excerpts, graphically represented as “scraps” of the original page.

The project is the source of concern for many writers, who consider that a virtual library represents a violation of their rights. Those who disagree with the project have raised many doubts, that range from the possibility of copyright violation upon the digitalization of the books to the possibility that hackers will easily breach Google’s security and promote the free distribution of the protected contents, including the many international law issues that could result from the project, given the differences that exist between copyright laws in each country. As an example, under Brazilian law, one needs the authorization from the author or holder of the copyright to include a work in any database.

Please note that the purpose of copyright laws, as well as of the Federal Constitution itself, is not only to protect authors and their works, but also to ensure the access to information and culture. Therefore, there are limits on copyrights resulting from the need to minimize potential losses thereto.

The new projects of virtual libraries show that the ongoing development of new technologies represents a great challenge in terms of copyrights, in light of the need to ensure protection to the interests and rights of the holders of intellectual works, while, at the same time, motivating citizen’s access to information and knowledge.

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