1.0 Market Overview:

1.1. - Briefly describe the structure of the capital market in the country. Please give the number of listed companies, their market capitalisation in the local currency and Euro, and express this by value in relation to GDP. Give a short description of the listed corporate sector in relation to others in the economy, including state owned, parastatal, joint ventures and privately owned companies.

The Brazilian securities market is governed by Law No. 6,385 of December 7, 1976, as amended (the “Securities Market Law”), which created the Comissão de Valores Mobiliários (or “CVM”, the Brazilian Securities Commission) and the Law No. 6.404 of December 15, 1976 (or Lei das Sociedades por Ações, the “Corporation Law”).

The Brazilian securities market is regulated by the CVM and the Central Bank of Brazil. Both the CVM and the Central Bank of Brazil implement the policies established by the Conselho Monetário Nacional (or “CMN”, the National Monetary Council) the highest authority responsible for monetary and financial policy in Brazil. The CVM has authority over stock exchanges and the securities market generally, being responsible for protecting investors and shareholders against fraud or manipulation with respect to any securities traded on the stock exchanges and promulgating accounting and reporting rules to ensure the availability to public of information on the securities being traded and the companies issuing them. The Central Bank of Brazil has, among other powers, licensing authority over brokerage firms and regulates foreign investment and foreign exchange transactions.

Under the Corporation Law, a company is either public (companhia aberta) or private (companhia fechada). A company becomes public when registered with the CVM. A company may be registered with CVM for the purpose of having its securities listed and traded on the Brazilian stock exchanges or in the Brazilian over-the-counter market. The shares of a public company may also be traded privately, subject to certain limitations. No minimum number of shareholders is required in order for a company to be considered a public company.

In order to be listed on Brazilian stock exchanges, a company must apply for registration with the CVM and the stock exchange where it intends to list its shares. Once this stock exchange has admitted the company for listing and the CVM has accepted its registration as a public company, its securities may, under certain circumstances, be traded on all other Brazilian exchanges. Listing requirements established by Stock Exchanges are normally simple.
Of Brazil’s nine stock exchanges, the São Paulo Stock Exchange (Bolsa de Valores de São Paulo, or “BOVESPA”) is the largest stock exchange in Brazil, accounting in 1998 for approximately 95% of the daily trading activity, seconded by the Rio de Janeiro Stock Exchange (Bolsa de Valores de Rio de Janeiro, or “BVRJ”), accounting in 1998 for approximately 5% of the daily traded activity. Each stock exchange is a non-profit entity owned by its member brokerage firms. Trading on each exchange is limited to member brokerage firms and a limited number of authorized nonmembers. The São Paulo Stock Exchange has two open out-cry trading sessions each day, from 10:00 a.m. to 01:00 p.m. and from 02:00 p.m. to 05:00 p.m. Trading is also conducted from 10:00 a.m. to 05:15 p.m. on an automated system referred to as “Megabolsa”. An “after market” session is conducted at the Megabolsa from 6:00 p.m. to 8:00 p.m. A “Homebroker” system permits investors to place their orders through the Internet. BVRJ recently closed its open-outcry trading floor and turned into an electronic exchange.

Settlement of transactions is effected three business days after the trade date without adjustment of the purchase price for inflation. Delivery of and payment for shares are made through the facilities of a separate clearinghouse for each exchange, which maintains accounts for member brokerage firms. The seller is ordinarily required to deliver the shares to the clearinghouse on the second business day following the trade date. The clearinghouse for the BOVESPA is CBLC — Companhia Brasileira de Liquidação e Custódia, which is owned by the brokerage firm members of BOVESPA, BOVESPA itself and other clearing members. The clearinghouse for the BVRJ is CLC — Câmara de Liquidação e Custódia S.A., which is 99%-owned by that exchange.

A company that is qualified to trade on one Brazilian stock exchange may qualify for trading on any other Brazilian stock exchange. On December 31, 1998, there were 535 companies listed on BOVESPA. On December 31, 1998, the aggregate trading volume on BOVESPA was approximately US$140 billion, the market capitalization of all listed companies was approximately US$161 billion, and seven of the ten companies with the largest capitalization listed on the stock exchanges in Brazil were controlled by the Government. Trades in securities listed on the Brazilian stock exchanges may be effected off the exchanges in certain circumstances, although the volume of such trading is limited. The table below sets forth some indicators of market activity on BOVESPA in the last five years:

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<tbody>
<tr>
<td>Number of Listed Companies</td>
<td>544</td>
<td>543</td>
<td>550</td>
<td>536</td>
<td>527</td>
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<tr>
<td>Market Capitalization(1)</td>
<td>189,058.18</td>
<td>147,560.35</td>
<td>147,560.35</td>
<td>255,409.31</td>
<td>160,886.69</td>
</tr>
<tr>
<td>Market Volume(1)</td>
<td>88,205.75</td>
<td>69,446.96</td>
<td>97,761,562</td>
<td>191,091,67</td>
<td>139,970,543</td>
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(1) In US$ Millions.
Source: BOVESPA

The Brazilian equity market is now Latin America’s largest in terms of market capitalization. The value of average daily trading volume increased from R$247 million in 1994 to R$687 million in 1997 and decreased to R$658 million in 1998, representing 60% of the Latin America trading value, according to BOVESPA.

Trading on Brazilian stock exchanges by non-residents of Brazil is subject to specific rules under Brazilian foreign investment legislation. In 1991, the Brazilian authorities created a mechanism (referred to as Annex IV) permitting foreign institutional investors to invest in the Brazilian stock exchanges through Portfolios managed by Brazilian fund managers. Foreign capital invested in the Brazilian securities markets represents an increasingly important share of total capital in the stock exchanges. Foreign investor participation in BOVESPA increased from $5.5 billion in 1993 to $10.9 billion in 1994, and decreased to $3.7 billion in 1997 and increased again to $7.6 billion in 1998. The foreign participation in BOVESPA declined in January 1999 to 25.1% from 34.6% in January 1998, in part due to the effects of the emerging markets crisis in 1998. In May 1998, it reached 27.6%. The Government has sought to regulate the flow of foreign Portfolio investment from time to time by varying the level of IOF (tax of exchange transactions) taxation on Annex IV inflows; the maximum level of IOF taxation the Government currently has authority to impose on such
inflows is 25%.

The Brazilian equity market is characterized by significant short-term price volatility, although the market has increased in value during the last three years as a whole. The closing levels (U.S. dollar adjusted) for the IBOVESPA, an index maintained by BOVESPA, were 51,343 at December 31, 1994, 44,201 at December 31, 1995, 63,111 at December 31, 1996. Solely for disclosure purposes and without affecting its method of calculation, the Index was divided by 10 on March 3, 1997. The closing levels (U.S. dollar adjusted) for the IBOVESPA were 10,196 at December 31, 1997 and 6,784 at December 31, 1998.

The Brazilian unorganized OTC market consists of direct trades between investors in which a duly qualified financial institution serves as intermediary. No special application, other than registration with the CVM, is necessary for securities of a public company to be traded in the unorganized OTC market. The CVM requires that it be given notice of all trades carried out in the unorganized OTC market by the respective intermediaries.

Sociedade Operadora do Mercado de Ativos (“SOMA”) is a private company organized in 1996 whose shareholders are various Brazilian stock exchanges, and it is the only OTC market organized in Brazil which has had its regulations approved by the CVM. In May 1999, SOMA had 109 listed companies and its aggregate trading volume was R$76,628,164 with an average daily trading volume of R$3,744,198.

Note: there are no publicly available statistics describing the listed corporate sector in relation to others, in the requested format.

1.2. - Are there any special governance rules pertaining to particular types of companies e.g. state owned companies or banks? For listed companies, please explain the industrial sectors they represent, and range of company size, by market capitalization. Please attach an appendix with the names of the main index of listed corporations.

State-owned companies. State-owned companies are subject to special corporate governance rules. The Brazilian government exerts significant influence over the manner in which state-owned companies operate, and it is generally entitled to elect the majority of the members of the Board of Directors, Executive Board and the Fiscal Board. For example, the Board of Directors of Petrobras is composed of twelve members. Four to seven of those directors (including the Chairman) are appointed by the President of Brazil, while three to six directors are elected by public sector shareholders (excluding the Federal Government), and one or two directors are elected by private sector shareholders. All members of the Executive Board are appointed by the President of Brazil.

On an annual basis, state-owned companies are required to submit their budgets for the next fiscal year to the Ministry to which they are subordinated (v.g., in the case of Petrobras, the Ministry of Mines and Energy). The budgets are then submitted to the National Congress for approval. The companies financial statements are regularly reviewed by the Federal Tribunal of Accounts (Tribunal de Contas da União). Although the level of financing and investment is regulated in this way, specific application of funds is left to the company’s discretion. Strategic objectives and planning are subject to supervision of the Ministry of Planning. Another regulatory body to which state-owned companies are subject is the Ministry of Finance. In addition, listed company such as Petrobras are subject to the jurisdiction of the CVM.

Independent Accountants. State-owned companies are also required to have independent auditors selected by them to audit its financial statements. Government policy also requires that the audit function for government-owned companies be put out to tender on a regular basis.

Management Contracts. A number of state-owned companies have entered into management contracts (contratos de gestão) with the Federal Government which grant greater flexibility in conducting their affairs that are otherwise permitted for state-owned companies. Such contracts provide for areas of company activities that no longer require prior authorization of the Brazilian government and sets out annual company targets in different areas of the company.
Companies Controlled by Brazilian States. Similar rules generally apply to state-owned companies controlled by Brazilian State Governments.

Financial Institutions. Financial institutions must submit to the Central Bank annual and semiannual audited financial statements as well as monthly unaudited financial statements, prepared in accordance with the standard accounting rules issued by the Central Bank for each type of financial institution. Public financial institutions must also submit quarterly financial statements to the CVM, as well as some quarterly and annual disclosure reports.

In addition, financial institutions are required to make full disclosure to the Central Bank of all credit transactions, foreign exchange transactions, export and import transactions, and other information relating to their economic activities. Such data are forwarded to the Central Bank either on a daily basis through computer transmission or through periodic report statements.

Private financial institutions must also inform the Central Bank about the election of statutory directors and executive officers, members of the Fiscal Board and other supervision/management bodies, within 15 days of the date on which these administrators are elected, and they can only assume their offices after they have been cleared by the Central Bank. The resignation of any administrator or member of another statutory entity must be immediately notified by the financial institution to the Central Bank’s regional office having jurisdiction over the institution.

Any corporate act involving a financial institution, including a capital increase or a change in the by-laws, will only become effective after the corresponding documentation is filed with and approved by the Central Bank.

Furthermore, the financial institution authorized to operate in the Brazilian financial market must provide the Central Bank with all information, documents and data required by the foreign authorities with regard to branches opened abroad.

Semiannual Accounts and Audits: Financial institutions must prepare financial statements on June 30th and December 31st of each year, observing the accounting rules set forth by the CMN and in the Corporation Law.

Financial institutions must have their financial statements audited by independent auditors registered with the CVM. The financial statements must include the financial statements of branches, financial and non-financial institutions located abroad in which the Brazilian financial institution has an equity interest of at least twenty five percent (25%) of the total capital stock.

Financial institutions are required to replace their independent accountants no later than every four consecutive years. The former independent accountant of a financial institution can be rehired only after three complete fiscal years have elapsed from its prior assignment to such financial institution.

Independent accountants are required to prepare the following reports: (i) a report on the audited financial statements examined with respect to compliance with accounting principles, as well as the relevant rules issued by the CMN and the Central Bank; (ii) a report evaluating the quality and adequacy of internal control procedures, including risk assignment criteria and data processing systems; and (iii) a report on compliance with applicable operational laws and regulations.

Each independent accountant is required to immediately communicate to the Central Bank any event that may materially adversely affect the relevant financial institutions’ status. Financial institutions are required to appoint an executive officer to a supervisory role in the area of accounting in order to ensure compliance with auditing and accounting rules and the rendering of accurate information to the Central Bank.

Financial institutions and their independent auditors must make available to the Central Bank, for at least five years, not only the financial statements and reports, but also working papers, correspondence, service contracts, and other documents regarding the audit works.
**Insurance Companies.** Insurance companies must submit to the *Superintendência de Seguros Privados* (the Superintendency of Private Insurance or “SUSEP”) annual and semiannual audited financial statements as well as monthly unaudited financial statements, prepared in accordance with the standard accounting rules issued by SUSEP. The semiannual and annual reports must be published in the press. Public insurance institutions must also submit quarterly financial statements to the CVM, as well as some quarterly and annual disclosure reports.

Insurance companies must also inform SUSEP about the election of statutory directors and executive officers, members of the Fiscal Board and other supervision/management bodies. The resignation of any administrator or member of another statutory entity must be immediately notified by the insurance company to SUSEP.

Any corporate act involving an insurance company, including a capital increase or a change in the bylaws, will only become effective after the corresponding documentation is filed with and approved by SUSEP.

**Other Regulated Activities.** A number of other activities are subject to special governance rules established by regulatory agencies, notably the oil and gas industry, which is subject to operational supervision and regulation by the National Petroleum Agency (ANP—*Agência Nacional do Petróleo*), the telecommunications activities, which are subject to operational supervision and regulation by the National Telecommunications Agency (ANATEL—*Agência Nacional de Telecomunicações*), and the electric sector activities, which are subject to operating supervision and regulation by the National Electric Energy Agency (ANEEL—*Agência Nacional de Energia Elétrica*). All such regulatory agencies establish reporting requirements to companies subject to their supervision and regulation, including filing of information about the election of statutory directors and executive officers, members of the Fiscal Board and other supervision/management bodies, and preliminary authorization requirements for corporate resolutions, including capital increases and changes in by-laws.

For a list of companies that compose the BOVESPA Index (IBOVESPA) see Appendix I.

*Note: there are no publicly available statistics explaining the industrial sectors represented by listed companies, and range of company size, by market capitalization, in the requested format.*

1.3. - Provide a brief description of the legal, regulatory and best practice bodies charged with developing, implementing, monitoring and enforcing governance standards for listed companies, their investors, accountants, advisers and auditors. Please provide contact details in the appendix. Explain what professional standards and means of enforcement exist for each. Please comment upon the effectiveness of the monitoring and enforcement of standards, with examples.

The CVM is the regulatory body charged with developing, implementing, monitoring and enforcing corporate governance standards for listed companies. Under the Securities Market Law, stock exchanges and organized OTC entities are self-regulating institutions with administrative and financial autonomy operating under the supervision of CVM. As auxiliary surveillance bodies, stock exchanges and organized OTC entities have authority to monitor their members and transactions held in their trading systems.

Trading of securities on the Brazilian stock exchanges may be suspended at the initiative of a Brazilian stock exchange or the CVM, based on or due to belief that, among other reasons, a company has provided inadequate information regarding a material event or inadequate responses to inquiries by such entities.

For contact details of legal, regulatory and best practice bodies charged with developing, implementing, monitoring and enforcing governance standards for listed companies, their investors, accountants, advisers and auditors, please refer to Appendix II.

1.4. - Which bodies have been active in promoting corporate governance standards or reforms in the market. Please provide a brief description of their activities, objectives, and achievements, including any codes of good practice issued. Append copies of relevant documents. Provide details of any monitoring, research or compliance requirements, and cite the source.
The promotion of corporate governance standards or reforms in the Brazilian market is still in an early stage of development. The IBGC — *Instituto Brasileiro de Governança Corporativa* (Brazilian Institute of Corporate Governance) is perhaps the first entity devoted to the matter. The IBGC has recently published a “Code of Best Practices of Corporate Governance” whose primary focus is on the Board of Directors. For copy and English translation of the IBGC Code please refer to Appendix III.

Another active promoter of corporate governance standards in Brazil is BOVESPA, which has developed a project called “Bovespa—*Empresas*” aimed at improving the relationship between companies and investors. In this sense, BOVESPA has published a number of manuals and publications notably the “Manual on Corporate Actions Communications”, “Bovespa’s Guide for IPO” and the “Bovespa’s Guide on Investors Relations”, in addition to an informal partnership with the IBGC which included the publication of the IBGC Code.

Likewise, a recent initiative for improvement of the standards in the Brazilian market was a document entitled “*ANBID’s Code of Self-regulation for Transactions of Public Placement and Distribution of Securities in Brazil*”, published by the *Associação Nacional dos Bancos de Investimento — ANBID* (the National Association of Investment Banks). This document set forth rules of conduct on distributions of securities offerings aimed at improving the level of disclosure of prospectus based on the standards of disclosure inspired on those imposed by the U.S. Securities and Exchange Commission. The Code requires disclosure on (ii) risk factors; (ii) company business; (iii) management discussion and analysis of financial statements; (iv) description of securities; (v) legal proceedings; and (vi) related party transactions. The Code is applied automatically to the institutions enrolled with ANBID and other participant institutions that adhere to its rules. All prospectus prepared in compliance with the ANBID Code will contain a legend informing that they comply with minimum information requirements imposed by the ANBID Code.

1.5. - Please provide a brief commentary explaining what domestic and international factors have led to corporate governance becoming an issue of concern for companies and investors, and explain what the barriers are to improvement in standards. Please comment on local views regarding the development of international standards. To what extent does the current system facilitate shareholder activism by institutional investors both foreign and domestic? If corporate governance has not been debated or taken forward, please comment upon why you consider this is, and whether there are pressures which will bring the debate forward in future.

The debate on corporate governance practices is still in an early stage in Brazil. At the outset, one must consider that the classic Berle & Means model of separation of ownership and control of U.S. corporations has never became a reality in Brazil. While in the U.S. the Berle & Means model resulted in the management control which abuses ultimately led to the shareholder activism movement for the improvement of corporate governance practices, in Brazil, despite the existence of a legal framework providing for the separation of the functions of owners and managers inspired in principles of U.S. corporate law, control of public companies has been kept in the hands of families or groups of individuals with a dominant ownership interest which in practice assume both management and controlling shareholder roles.

This control profile has its historical roots in the model of development of the Brazilian stock market which dates from in the early 70’s. This model was based on tax incentives, such as the so called *Fundo 157*, which a created a tax allowance for the acquisition of primary shares, and a captive market resulting from an legislation that obliged pension funds to invest in shares of Brazilian listed companies.

Another key factor (which unlike the factors pointed out in the previous paragraph is still in force) is a rule set forth in the Corporation Law that authorizes Brazilian corporations to issue non-voting preferred shares representing up to two-thirds of its capital stock. This rule has allowed controlling shareholders or Brazilian public companies to retain absolute control by holding shares representing 17% of the capital stock, assuming a company with one-third of common voting shares (33%) and two-thirds of preferred non-voting shares (67%). Preferred non-voting shares represent the vast majority of the shares traded in the Brazilian stock exchanges. The few common shares floated in the open market generally have low liquidity, which makes them unattractive and undervalued.
A heated debate occurred in the early nineties with respect to the two-third threshold for issuance of non-voting shares. The CVM prepared a draft bill of law aimed at amending and up-dating the Corporation Law, which included the reduction of such threshold for non-voting shares to 50% of the aggregate capital stock. Public companies, led the ABRASCA — Associação Brasileira de Companhias Abertas (the Brazilian Association of Public Companies) strongly opposed such change, and the draft bill has never been submitted to Congress.

With no voting rights, Brazilian investors in public companies’ shares have been mostly passive investors. Nevertheless, in the nineties, a number of failures of listed companies has raised public concern for the need of an improvement in corporate governance standards. The liquidation by the Central Bank of large Brazilian private sector banks revealed huge schemes of fraud in their accounting records and books, and raised doubts about the role of independent accountants. Likewise, failures and financial difficulties of certain listed companies evidenced bad management practices and abuses of controlling shareholders.

At the same time, institutional investors, notably pension funds, have started to seek a more active participation in boards of directors of Brazilian companies, and acquired control or significant interests in certain listed companies, such as Perdigão and companies being privatized by the Brazilian government, such as steel producers Usiminas, Acesita, and Companhia Siderúrgica Nacional, the giant mining company Companhia Vale do Rio Doce, and a number of telephone companies sold after the Telebrás spin-off.

Up to the present moment, the Brazilian privatization program elected to use an auction system rather than using a system of wide distribution of shares. The active presence of institutional investors such as pension funds and banks in the consortia formed to bid in privatization auctions has introduced new corporate governance models, notably in CSN and CVRD, in which control is shared by a group of investors bound by a shareholders’ agreement, with the majority of Board of Directors’ seats being distributed among the members of the control group. This new shared control model, in which a group of investors share the company control is viewed by a number of experts as a trend for the near future, as the privatization program goes forward.

During 1999, a major dispute among controlling shareholders and minority investors and the CVM for alleged abuse of power raised as a result of corporate restructuring transactions undertaken by recently privatized companies in the telecommunications and electric sector. Holding companies owned by controlling shareholders were merged into listed operating companies in order to allow amortization of the goodwill paid in the privatization auction for tax purposes. In certain cases, the acceptance of the use of book value for purposes of calculation of the ratio of shares received by controlling shareholder as a result of the merger has made it possible for controlling shareholders to dilute minority shareholders through the downstream merger transaction. In other cases, controlling shareholders have attempted to transfer the debt incurred for acquisition financing to the operating company without diluting their equity interest. The CVM has intervened in a number of those transactions to protect minority shareholders and in early December issued comprehensive regulations for such transactions intended to provide an equitable treatment for minority and controlling shareholders.

The internationalization of the Brazilian capital market, with a growing number of Brazilian public companies accessing the U.S. and international capital markets through American and Global Depositary Receipt Programs, and the increase in foreign portfolio investment in Brazilian stock market, and the opening-up of the financial system for foreign controlled institutions with higher demand for quality information has triggered a process of improvement of corporate governance practices, notably with regard to financial and operational reporting standards.

Looking forward, the corporate governance is rapidly starting to become an issue of concern for companies, investors and regulators, which probably makes this the right moment for improvements in Brazilian standards.

Perhaps the principal barrier to improvement in corporate governance standards is the lack of a strong activism of institutional investors, who have accepted to acquire preferred non-voting shares (relying solely on the higher liquidity currently offered by such shares) and maintained a passive investor attitude. While certain market players advocate a statutory change to reduce or abolish the permission for the float of non-
voting shares, we believe that a solid improvement of corporate governance standards, and to a great extent the creation of stock market that could actually supply capital needs of Brazilian private sector companies in an ever increasing competitive economic environment, could be reached through educational initiatives targeted to improving institutional investors requirements for investing in the stock market.

1.6. - Explain the pattern of corporate ownership in the private and parastatal sectors, explaining the proportion of shares which are freely traded, those which are closely held, cross shareholdings, debt/equity instruments and other relevant elements in the structure of share ownership, including Government, institutional, private and foreign holdings.

One of the major factors pointed by market participants as deterring the development of Brazilian stock market is the low of liquidity levels for stocks of the vast majority of listed companies (notably in the private sector), since although listed companies have substantial capitalization in the form of equity, the majority of shares issued and outstanding are in the hands of controlling shareholders, institutional investors, or in treasury, which in practice reduces the so called “free float” to a minimal amount of shares.

In certain economic sectors, the steel sector being a landmark, a web of cross shareholdings from strategic investors (competing companies), pension funds (notably Previ, closed-end pension fund for employees of Banco do Brasil, and in which Brazilian Federal Government has substantial influence) and financial investors (such as banks and related insurance companies and open-end pension funds), is also a key for an understanding of the pattern of ownership of Brazilian listed companies.

More recently, foreign holdings have taken an important share of Brazilian listed companies as a result of their increasing activity in privatizations and mergers and acquisitions. Foreign companies have generally elected to delist or at least reduce the float of stocks of acquired companies, by means of market buy orders, tender offers, and buyback programs as the Brazilian capital market is normally less attractive than the home capital markets of foreign companies for funding purposes. This factor may represent a future obstacle to the development of the Brazilian stock market as a number of public companies went private following acquisitions by foreign controlled groups in the past few years.

Note: there are no publicly available statistics describing the pattern of corporate ownership in the private and parastatal sectors, explaining the proportion of shares which are freely traded, those which are closely held, cross shareholdings, debt/equity instruments and other relevant elements in the structure of share ownership, including Government, institutional, private and foreign holdings, in the requested format.

1.7. - Explain any rules, and regulatory oversight relating to changes in company control, specifying any provisions that relate to shareholders. Your discussion may exclude rules for other objectives such as foreign investment and competition. Give a commentary on the effectiveness with which these are monitored and enforced. Are there material restrictions on the ability of an investor to launch a hostile takeover bid? Is there a functioning bankruptcy system?

Change in Company Control. Prior to the latest partial reform of the Corporation Law introduced by Law No. 9457 of May 5, 1997, the acquiror of a controlling stake in public companies were required by article 254 (expressly repealed) to make a tender offer for the voting stock held by minority shareholders, at the same price and on the same conditions as those offered the controlling shareholders. National Monetary Council Resolution No. 401 of December 22, 1976, in turn, set out the major rules applying to such tender offer, on which the CVM approval for the intended ownership control transfer was conditioned. Such resolution also established that only minority shareholders holding voting shares were entitled to such mandatory tender offer, thus depriving the vast majority of investors (who normally own preferred non-voting shares) from the right to tag their shares along with the controlling shareholder in a sale of control.

Under the erstwhile system, the shareholding control transfer was promptly released by the company to the market, in the form of a material fact stating the price and conditions of the deal. At a later stage, the draft tender offer was submitted for CVM approval, and when approved, such offering was published and widely circulated on the market.
Under the new system introduced by the statutory change, the tender offers are no longer required for the sale of a controlling stake; consequently, the material facts published by the companies only referred to the existence of a deal and stated the name of the new controlling entity, with no further information whatsoever on the price, terms and conditions of the transaction.

After the acquisition of shareholding control under this new system, some of the new controlling entities voluntarily bid for minority stakes, and even tendered offers with a view to delisting the company involved; in such cases, however, the minority shareholders had no access to the share price offered to the controlling shareholder. Some minority shareholders raised their voices against this inequitable treatment afforded them by the new controlling entities, but were unable to exercise any legal right.

In an attempt to put an end to such controversies, CVM issued Instruction CVM 299 of February 9, 1999, setting new guidelines, among others, for disclosure of transactions involving the transfer of ownership control or the acquisition of shares by the controlling entity. Under this new rule, a controlling shareholder or the persons representing its interests in any way are required to advise CVM, as well as the market, of any agreements or arrangements for the transfer of a controlling interest in public companies, or even the granting of an option or mandate to that end. The confidentiality of a deal may nevertheless be requested if required to safeguard the company’s legitimate interests.

After the deal is closed, the purchaser of a controlling stake in a public company must disclose the following information:

- name and particulars of the new controlling entity, coupled with an overview of its market segments and sphere of activities;
- name and particulars of the seller(s), including on an indirect basis, if any;
- price and other material characteristics/conditions of the deal;
- objective of the purchase;
- number and percentage of acquired shares, per type and class, vis-à-vis the voting and overall capital stock;
- information on any agreements or arrangements governing the exercise of voting rights, or the purchase and sale of securities issued by the company;
- affirmative or negative statement related to the intention of delisting the company;
- other material data referring to future plans affecting the company’s business, notably as regards specific events envisioned for the company.

Finally, the purchaser of ownership control is also required to provide CVM with a copy of the sale-related documentation, including the share purchase and sale agreement, within ten days of release of the respective deal in the press.

**Mandatory Tender Offer by the Controlling Shareholder.** In addition to regulations on the change of control, CVM Instruction 299 established that any increase of 10% or higher in the same class or type of shares held by the controlling shareholder must be carried out by way of tender offer.

**Hostile Takeover Bids.** Hostile takeover bids are unusual in Brazil because of the concentration of control in hands of family groups that own the majority of the voting shares of Brazilian public companies. In practice, all takeover transactions are negotiated with a friendly acquiror and conducted through a private transaction. The Corporation Law authorizes any person interested in acquiring control of a public company to attempt to do so pursuant to a tender offer to all shareholders. This offer is governed by articles 257 through 263 of the Corporation Law. The basic rules to be complied with are the following:

- the offer must be effected with a financial institution acting as underwriter;
- the offer must be irrevocable during the period of validity established by the bidder; and
- the bidder must state the minimum number of shares that he will purchase and the maximum
number of shares, if any. In this case, if the shares tendered exceed the maximum number of shares established in the offer, the shares actually tendered shall be subject to apportionment.

Bankruptcy System. In Brazil, the bankruptcy system is regulated by Federal Decree Law No. 7661 (Lei de Falências, the “Bankruptcy Law”), which was enacted in 1945 (as amended), and contemplates two distinct types of insolvency proceedings:

- **Concordata** proceedings, which aim to rehabilitate the debtor and are roughly equivalent to a Chapter 11 reorganization under the U.S. Bankruptcy Code.
- **Falência** proceedings, which contemplate a liquidation of the debtor's business, and resemble a Chapter 7 liquidation under the U.S. Bankruptcy Code.

Brazilian bankruptcy cases are handled by State Court judges. In certain large cities, where a number of State Court judges are sitting, special courts have been assigned to hear bankruptcy cases. The judge with jurisdiction over the place in which the headquarters or main offices of a company are located is authorized to hear such cases. Once bankruptcy has been declared, all subsequent suits involving the bankrupt company are allocated to the judge in charge of the corresponding proceeding.

For a summary of **Concordata** and **Falência** proceedings please refer to **Appendix IV**.

Although the Bankruptcy Law favors the company and its controlling shareholders to the detriment of creditors, experts in bankruptcy law argue that experience has demonstrated that it has failed to promote the financial recovery of companies in financial difficulties. There is a consensus that Bankruptcy Law is outdated. **Concordata** and **falência** have been time consuming proceedings that may several take years until their conclusion. The intention to favor the company’s recovery has only served to protect the controlling shareholders and administrators of bankrupt companies while reducing the offer of credit to Brazilian companies. For a summary of the proposals under discussion for a reform of the Bankruptcy Law please refer to **Appendix V**.

1.8. - Are the courts reasonably reliable as a mechanism for protecting shareholder rights? Please comment of the speed and cost of court proceedings.

Lawsuits dealing with violation of shareholders rights are generally handled by State Court judges. The judge with jurisdiction over the place in which the headquarters or main offices of a company are located is authorized to hear such cases. No special courts have been assigned to hear corporate cases and jurisprudence is poor because of scarcity of judicial precedents. Nevertheless, courts have been reasonably reliable as a mechanism for protecting shareholders rights. Although in a number of cases courts have granted preliminary injunctions to suspend the effects of attempted abuses of power, court proceedings may take considerable time until a final and unappealable decision is reached, and the prejudiced party may incur substantial costs prior to being able to enforce his rights or receive damages.

2.0 Disclosure and Transparency:

Brazilian public companies are subject to reporting requirements and are required to update their registration by providing certain information to CVM and to the stock exchanges where their securities are traded.

The main regulations regarding disclosure and transparency are contained in CVM Instruction No. 202 of December 6, 1993, which amends and restates the rules governing registration with CVM and provides for periodic and occasional reporting requirements; CVM Instruction No. 31 of February 8, 1984, which contains the main regulation regarding insider dealing, regulates disclosure and use of information on material acts and facts; and CVM Instructions Nos. 69 of September 8, 1987 and 299 of February 9, 1999, which provide for disclosure on the acquisition of relevant blocks of shares, among other matters.

2.1. - Explain what elements of corporate financial and operational performance must be disclosed, to whom, how provided and over what timetable are they available. Please distinguish between legal, regulatory and best practice requirements for both financial and non-financial
information. Where local financial reporting requirements do not reflect international standards (either U.S. GAAP or IASC) please explain the main differences. Provide examples of how these are monitored and what penalties are imposed for any breach.

Financial and Operational Periodic Reporting Requirements: Brazilian public companies are required to file:

- annual audited financial statements (which under Corporation Law are composed of a Balance Sheet; a Statement of Operations; a Statement of Changes in Stockholders’ Equity; a Statement of Changes in Financial Position; and the Notes to Financial Statements), accompanied by the Management Report and the Report of Independent Accountants, at least one month before the date of the annual general shareholders’ meeting, which must take place no later than April 30 or on the date which the company’s financial statements are published or made available to shareholders, if such date occurs more than one month prior to the date of the annual general shareholders’ meeting;
- standardized financial statements on form Demonstrações Financeiras Padronizadas—DPF, within the same time period established for submission of annual audited financial statements;
- annual information reports on form Informações Anuais—IAN, within 30 days after the end of the annual general shareholders’ meeting; and
- quarterly unaudited (limited review only) financial statements on form Informações Trimestrais—ITR, within 45 days after the end of each of the first, second and third quarters).

The financial, quarterly and annual information reports include, among other things, information on the company’s shareholders, directors and officers, controlled and associated companies, the company’s general operations, and a brief discussion and analysis of the company’s results and operations.

Public companies that disclose abroad statements or information (such as U.S. GAAP financial statements and annual reports on Form 20-F) in addition to those required under corporate law or under the norms enacted by CVM must also disclose such statements and information in Brazil.

These reports must also be filed by the company with the stock exchanges in which the company’s securities are listed.

Forms DPF, IAN and ITR must be filed in diskette, generated from a computer program approved by CVM, with may be downloaded at the CVM web-site. Other periodic and occasional reporting requirements are filed under Form Informações Periódicas e Eventuais —IPE, also available at the CVM web-site. All filings and information provided with the CVM and relevant stock exchanges are publicly available through these institutions, and most of the information is also currently available on their web-sites on the Internet.

Although compliance by Brazilian public companies with the reporting requirements of the CVM and the relevant stock exchanges have been satisfactory, the CVM has recently established severe penalties to be imposed on non-compliant companies.

Brazilian companies without securities traded in Brazil are not required to provide public information to the CVM and stock exchanges, but private companies organized in the form of sociedade anônima (corporation) must have their financial statements published in newspapers and filed with the state Board of Trade, while private companies organized as sociedade por quotas de responsabilidade limitada (limitada companies) have no obligation to disclose financial information, other than filing tax returns with tax authorities, which are treated as confidential information.

2.2. - What requirements are there for financial and/or other statements to be subject to an independent audit? How are external auditors appointed and removed? What regulation is there of auditors to establish auditing standards and ensure professional conduct? Please give examples to illustrate the effectiveness of enforcement of these.

Brazilian private or public companies organized in the form of sociedades anônimas (corporations), must maintain their accounting books and records in accordance with the Brazilian corporate law, the Corporation Law, and generally acceptable accounting principles and standards. Accounting principles and standards
generally applicable in Brazil (Brazilian GAAP) are established by the Instituto Brasileiro de Contadores—IBRACON (Brazilian Institute of Accountants, or “IBRACON”). Brazilian GAAP differ in certain material aspects from the accounting principles and standards accepted in the United States (U.S. GAAP) and International Accounting Standards (IAS).

Public companies also are subject to supplementary regulations issued periodically by the CVM. Financial statements of public companies must be audited by independent accountants registered with the CVM. Rules regarding registration of independent accountants with CVM were recently amended and restated by CVM Instruction No. 308 of May 19, 1999. The new regulations follow guidelines and recommendations of International Organization of Securities Commissions — IOSCO, notably the IOSCO Resolution on International Auditing Standards.

The CVM Instruction imposed the following new requirements for registration of independent accountants:

- The independent accountant must be submitted to a technical qualification examination jointly held by Conselho Federal de Contabilidade – CFC (the Federal Accounting Board) and the IBRACON.
- An internal control program must be implemented in accordance with the CFC and IBRACON rules and guidelines for assurance of compliance of audit norms.
- The internal quality control program must be reviewed every four years by another auditor, who must prepare and deliver a report to CVM.
- A continued education policy for its personnel must be maintained in accordance with guidelines issued by the CFC and the IBRACON.

CVM Instruction 308 established the following new rules:

- Independent auditors and individuals or companies related to them are prohibited from acquiring or holding securities issued by their audited entities and controlled or associated companies or companies of the same economic group.
- Independent auditors are prohibited from rendering to their audited entities consulting services that may characterize the loss of objectivity and independence. According to CVM Instruction 308, consulting services that may compromise the independence of the auditor include without limitation: (i) corporate restructuring; (ii) valuation of companies; (iii) asset revaluation; (iv) determination of amounts for purposes of setting provisions or technical reserves and contingency provisions; (v) tax planning; (vi) remodeling of accounting, information and internal control systems; or (vii) any other service that may influence decisions of their audited entities. The breach of this obligation is considered a serious infraction; lack of independence, if verified, may result in the audit work being considered void.
- Mandatory rotation: an independent auditor may not render services for the same public company for a term higher than five consecutive years; a minimum three-year interval is required before the independent auditor may be rehired by the client.

The prohibition from rendering consulting services to audited entities have been challenged in court by certain independent auditors, including PricewaterhouseCoopers, the largest auditing firm in Brazil, who contest the CVM authority to restrict their activities.

Under the Corporation Law, the appointment and removal of the independent auditor is made by the Board of Directors.

For a summary of the principal differences between Brazilian GAAP and U.S. GAAP and IAS please refer to the Appendix VI.

2.3. - Set out any disclosure requirements relating to ownership in the company. Specify where and when such disclosure must be made, including monitoring and enforcement provisions.

The Annual Report on Form IAN requires disclosure of the ownership position of shareholders holding more than 5% of the voting capital stock, including name, nationality, number and percentage of common shares, number and percentage of preferred shares, number and percentage of total shares, participation in
shareholders’ agreement, and control. Controlling shareholders’ interest must be disclosed up to the level of individuals.

**Increase in Ownership Interests.** Instruction CVM No. 69 of September 8, 1987 requires disclosure on the acquisition of voting stock in public companies. A person or group of persons that acquires a stockholding equal to or higher than 10% of the voting capital must make a statement in the press containing, among others, information on the purpose of the transaction and the number of shares held by the purchaser. Further announcements must be published whenever such ownership interest increases by at least 5%.

Instruction CVM 299 of February 9, 1999 expanded disclosure requirements to any transaction actually or potentially increasing the ownership interest of the controlling shareholder by five percent of any type and/or class of shares, either voting or nonvoting.

Pursuant to Instruction CVM 299, this disclosure requirement also applies to the actual or potential acquisition of shares or increase in ownership interests by the management and Fiscal Board members of public companies. Potential increase is defined by CVM as an increase in ownership interests by way of acquisition of convertible debentures, subscription bonuses and/or other securities convertible into the company’s shares.

In addition to such compulsory disclosures, CVM may also call for publication of a material fact in the newspapers where the company usually makes its disclosures, which must contain at least the following data:

- name and particulars of the notifying agent(s);
- quantity, price, type and/or class of shares, in the event of acquisition of stock;
- quantity, price, and characteristics of other securities then acquired;
- the acquisition method;
- average quotations for the securities of the same type and/or class as those acquired, over the last 90-day period, on stock exchanges or organized over-the-counter markets in which they are traded;
- the reasons and objectives of the purchaser(s); and
- information on any agreements or arrangements regulating the voting rights or the purchase and sale of the company’s securities.

2.4. - Set out any disclosure requirements relating to the company’s directors, managers and advisers. What requirements exist for disclosure of the identity, compensation, equity ownership, and background of directors and managers, and of any relationships between a director, the company and managers? Specify where and when such disclosure must be made, including monitoring and enforcement provisions. Please provide examples to illustrate how effective this is.

The composition of the Board of Directors and the Executive Board must be disclosed on the Annual Report on Form IAN, including name, enrollment with the National Registry of Legal Entities (C.N.P.J.), date of election, term of mandate, and position. The disclosure includes a curriculum with information on professional experience and academic background.

Form IAN requires disclosure of aggregate compensation and profit participation of directors and executive officers. Pursuant to an amendment to the Corporation Law enacted on May 5, 1997 (Law No. 9,457), the maximum aggregate compensation for Directors and Executive Officers for each year is established annually at the company annual shareholder meetings.

The disclosure required on Form IAN also includes a three-year information breaking down amounts distributed to debentureholders, employees, directors and executive officers, founders’ shares, and contributed to assistance and pension funds or similar, and net income.

No disclosure is required for equity ownership of director and executive officers, unless such disclosure is made in the capacity of controlling shareholder or shareholder owning more than 5% of the voting capital stock.
2.5. - Are there disclosure requirements for related party transactions? If so, how are these monitored and enforced. Is insider dealing a recognised offence under either civil, criminal or regulatory provisions? Are there enforceable sanctions against insider dealing? Please provide examples.

**Related Party Transactions.** Public companies are required by CVM to disclose related party transactions in the notes to the financial statements pursuant to CVM Ruling No. 26 of February 5, 1986, which approved the IBRACON pronouncement on related party transactions. Brazilian financial statements do not have the same level of disclosure for related party transactions, as required by US GAAP.

Form IAN also requires disclosure of transactions with related parties.

In addition, the Corporation Law establishes that the notes to the financial statements on relevant investments must contain precise information on the controlled and associated companies, indicating, among other information, the amount of revenues and expenses in operations amongst the company and its controlled and associated companies. An investment is considered relevant (i) in each controlled or associated company, if the book value is equal or superior to ten per cent of the company’s stockholders’ equity; and (ii) in the aggregate of controlled and associated companies, if the book value is equal or superior to fifteen per cent of the company’s stockholders’ equity.

The administrator may not interfere in any corporate business where he has a conflict of interest with the Company, as well as in the resolution thereof taken by the remaining administrators. The impediment must be informed and the nature and extent of his interest must be transcribed in the minutes of the board of directors or executive board meeting.

**Insider Dealing.** The principal legal instruments in Brazil to ensure a fair market and curb insider dealings are contained in the Corporation Law, in the Securities Law and in the following regulations issued by CVM:

- CVM Instruction No. 8 of October 8, 1979, which defines and prohibits the creation of artificial conditions of supply, demand or securities pricing, manipulation of prices, fraudulent transactions and use of inequitable practices.
- CVM Instruction No. 31 of February 8, 1984, which contains the main regulation regarding insider dealing, regulates the disclosure of and use of information on material acts or facts.
- CVM Instruction No. 202 of December 6, 1993, which amends and restates the rules governing registration with CVM of companies who trade their securities on stock exchanges and on the over-the-counter market, and provides for periodic and occasional disclosure requirements to CVM for the updating of a company’s registration.
- CVM Instruction No. 299 of February 9, 1999, which imposes additional disclosure requirements on the change of control of public companies.

Brazilian law on this issue establishes norms of a preventive nature, by regulating the duties of loyalty, confidentiality and full disclosure by the administrators of a public company, and also attempts to discourage transgressions by means of liabilities and the application of sanctions.

Brazilian rules designed to curb insider trading are two-fold:

- **Preventive rules.** They reflect the legal principle that the administrator of a public company shall base his conduct on compliance with the precept of full disclosure, i.e., the full disclosure of material information to the market. From this principle results another, which states that such information shall be made public to everyone simultaneously (fair disclosure).
- **Repressive rules.** They impose sanction on those who commit insider trading. The CVM has authority to start an administrative investigation on illegal acts and non equitable practices of administrators, shareholders of public companies, intermediaries, and other market participants, being entitled to apply the sanctions provided for in the Securities Law.
The Corporation Law generally establishes that the management of a public company must promptly disclose to the stock exchanges, as well as publish in the press, any resolution passed at general meetings or taken by the company’s management bodies, or any other material fact involving the company’s business, which may influence the investors’ decision to purchase or sell the company’s securities. While the Corporation Law requires disclosure material information relating to the company’s own business (inside information), there is no requirement to provide information on matters beyond the scope of the company’s business (market information).

Instruction CVM No. 31 of February 8, 1984 defined as a material fact any resolution passed at general meetings or decision made by the management bodies of a public company, or any other act or fact occurring during the course of business of a publicly-held company that could considerably influence:

- the quotation of securities issued by the company; or
- the investors' decision to trade them; or
- the investors' decision to exercise rights inherent to the holders of such securities.

Investor Relations Officer. Material acts or facts must be communicated and disclosed to the market, CVM and stock exchanges by the public company's investors relations officer, who will also be responsible for making such information available to the holders of securities issued by the company.

Confidential Information. Administrators may exceptionally refrain from disclosing any act or fact which, if revealed, could put the company's lawful interests at risk. Such information must be immediately disclosed, however, if it goes beyond the control of the administrators, or in the event the company's shares show unusual oscillations; in the event of a leak, the procedure to be followed is full disclosure. Any information not yet revealed to the public must be treated in confidence, and the administrator shall not make use of such information to obtain any advantages for himself or for third parties by purchasing or selling securities. The administrator must also ensure that such obligation is not infringed by a subordinate or third party enjoying his confidence. Any person detrimentally affected in a purchase or sale of securities with inside information may demand indemnification for losses and damages from the person responsible for the infringement, unless the person was aware of the information at the time the contract was made.

CVM Instruction 31, also establishes that controlling shareholders of public companies, like administrators, may not make use any information to which they have privileged access relating to a material act or fact not yet disclosed to the market in order to obtain advantages for themselves or others by means of trading with securities.

CVM has the authority to use special administrative investigations to determine any unlawful acts or inequitable practices by public company administrators or shareholders, intermediaries and other market participants, and apply the penalties provided for in article 11 of the Securities Law, which are:

- warning;
- fine;
- suspension of the position of administrator or member of the Fiscal Board in a public company or an entity in the securities distribution system or other entities that depend on the authorization or registration with the CVM;
- temporary disqualification for the positions referred to in the previous paragraph, up to a maximum of 20 years;
- suspension of authorization or registration for performance of the activities under the Securities Market Law, which includes all activities comprising the securities industry;
- annulment of the authorization or registration referred to in the previous paragraph;
- temporary prohibition to practice certain activities or transactions, for the members of the securities distribution system or of other entities that depend on authorization or registration with the CVM, for a maximum of 20 years;
- temporary prohibition to act, directly or indirectly, in one or more kinds of transactions in the securities market, for a maximum of 10 years.
The fine imposed must not exceed the higher of these amounts:

- R$500,000.00;
- 50% of the value of the irregular issue or transaction;
- three times the amount of the economic advantage obtained or the loss avoided as a result of the illicit.

In case of recidivism the CVM may alternatively apply a fine up to the triple of such amounts or any of the last five penalties listed above.

In addition to being subject to such administrative investigation, an insider may also be subject to civil liability, for reparation of the damage caused. Insider trading is not a specific criminal offence in Brazil. From 1988 to 1997 Congress examined Bill No. 1317, proposed by the Executive Branch of Government, which sought to define and punish crimes involving the securities market. If enacted, the Bill would make insider trading, and malpractices such as manipulation of prices and non-disclosure of material information to the public, a criminal offense. Nevertheless, the Bill was withdrawn by the Government.

2.6. - Please set out any other disclosure provisions relevant to corporate governance, such as voting outcomes or minutes of general meetings. Provide examples of disclosure which are regarded locally as best practice, citing particular companies.

Other disclosure provisions relevant to corporate governance include periodic and reporting requirements:

**Periodic Reporting Requirements:**

- notices of annual shareholders’ meetings, on the same day such notices are published in major newspapers, as required by the Corporation Law;
- summaries of the decisions made at the annual shareholders’ meetings, on the business day subsequent to the date of such meeting; and
- minutes of the annual shareholders’ meetings, within 10 days of the date of such meetings.

**Occasional Reporting Requirements:** In addition to these filings, Brazilian companies are required to provide the CVM and the relevant stock exchanges with:

- notices of special shareholders’ meetings, on the same day such notices are published in major newspapers, as required by the Corporation Law;
- summaries of the decisions made at the special shareholders’ meetings, on the business day subsequent to the date of such meeting;
- minutes of the special shareholders’ meetings, within 10 days of the date of such meetings;
- copies of shareholders’ agreements, upon filing with the company;
- information concerning any concordata or bankruptcy procedures initiated by or with respect to the company; and
- announcements of material acts or facts, on the same date of its press release.

Brazilian public companies are also required by CVM and the relevant stock exchanges to make announcements regarding material acts or facts with respect to their corporate affairs which may affect the market value of their publicly traded securities. Trading of securities on the Brazilian stock exchanges may be suspended at the request of a company in anticipation of a material announcement.

Private companies are also required to file with the Board of Trade resolutions taken at general meetings and board of directors’ or executive board’ meetings that may affect third parties. Copies of such documents may be obtained at the applicable Board of Trade.

ABAMEC — National Association of Market Analysts (Associação Brasileira de Analistas de Mercados)
promotes an annual award for public companies with disclosure policies regarding locally as best practice. Companies such as IKPC — Indústrias Klabin de Papel e Celulose S.A., a pulp and paper producer, Companhia Brasileira de Distribuição, a retail company which owns the Pão de Açúcar supermarket chain, and CVRD — Companhia Vale do Rio Doce, a mining company are examples of companies which disclosure policies are acknowledged as best practice.

2.7. - Provide a commentary upon areas of weakness in the current disclosure regime where reforms are needed, with an indication of whether there is support for such reforms internally and the main barriers that you see to implementing change.

The financial, quarterly and annual information reports do not have the same degree of detail and in-depth analysis and discussion of U.S. periodic reports. In fact, the information contained in such reports is generally considered to be poor by market analysts. In early 1999 the CVM has announced the intention to revise and amend CVM Instruction No. 202 to improve the standard of disclosure requirements. One of the intended goals is to require a more in-depth analysis of the company’s results and operations.

The wide support from Brazilian securities market to the new “ANBID’s Code of Self-regulation for Transactions of Public Placement and Distribution of Securities in Brazil” has indicated a trend toward an improvement in the levels of disclosure of Brazilian prospectuses for local underwriting transactions. Until very recently, only companies with securities traded abroad had an level of disclosure in line with international standards. On the other hand, a substantial number of administrators of public companies are still reluctant to improve the level of disclose made to the public in an attempt to limit the information available to competitors.

The CVM has commissioned a group of experts to prepare a new bill of law for a reform of the Corporation Law aimed at harmonizing accounting practices in Brazil with those prevailing on the world financial markets, based on the recommendations of the International Accounting Standards Committee (IASC).

The bill proposes several changes in accounting statements, notably the replacement of the Statement in Financial Position (Demonstraçao das Origens e Aplicacao de Recursos) for the Statement of Cash Flows (Demonstracao de Fluxos de Caixa), and the introduction of a new Statement of Value Added (Demonstracao de Valor Adicionado). A number of changes regarding the preparation of the Income Statement and the Balance Sheet have also been included in the bill to improve the quality of Brazilian accounting statements.

One of the most polemical points of these modifications is that private companies (including limitadas, a type of company similar to the U.S. limited liability companies) with gross revenues superior to R$ 150 million or total assets higher than R$ 120 million, defined as Large Companies (Sociedades de Grande Porte) will be required to publish and file with the Board of Trade financial statements, in addition to being subject to the surveillance and regulatory powers of the CVM.

The bill was submitted by the CVM to the Ministry of Finance and is expected to be sent by the Executive Branch of Government to the Congress in the near future.

3.0 Equitable Treatment of Shareholders

• Corporate governance rights and responsibilities can be guaranteed through a number of means including laws, regulations, stock exchange listing requirements or rulings of regulatory agencies. We would ask that the respondents specify the relevant statute, guideline or listing requirement for each provision.

3.1. - Please explain any provisions which give shareholders formal powers in relation to the
governance of the company. Explain whether there are any provisions which require in law or practice that shareholders be treated equally or differently with respect to corporate actions. Please provide examples.

The Corporation Law provides for two different types of shareholders meetings: An annual shareholders meeting (assembléia geral ordinária) must be held within the first four months of the end of the fiscal year, with the following order of business: (i) approve the management accounts, examine, discuss and vote the financial statements; (ii) resolve on the allocation of net income for the fiscal year and the distribution of dividends; and (iii) elect the management (Board of Directors) and members of the Fiscal Board, if this is the case. A special shareholders’ meeting (assembléia geral extraordinária) may be called and held to decide all other matters whenever the interest of the company so requires. At a properly called and held shareholders’ meeting, shareholders may decide all matters relating to the purposes of the company and pass resolutions as they may deem necessary for the protection and well-being of the corporation.

A shareholders meeting is convened by publishing, no later than eight calendar days prior to the scheduled meeting date and no fewer than three times, a notice in Diario Oficial (Official Gazette) in the state where the company’s head offices, and in a newspaper with wide circulation in the city where the company’s head offices are located. Such notice must contain the order of business for the meeting and, in the case of an amendment to the by-laws, and indication of the subject matter.

A general shareholders’ meeting may be held if shareholders representing at least one quarter of the voting capital are present, except in the case of a general meeting for the purpose of amending the by-laws, for which shareholders representing at least two-thirds of the voting capital must be present. If no such quorum is present, a second meeting may be called by notice given at least five calendar days prior to the scheduled meeting date and in the same manner as described above, and the meeting may then be convened without any specific quorum requirement, subject to supermajority voting requirements for certain matters, as discussed below. A shareholder without a right to vote may attend the general shareholders’ meeting and take part in the discussions of matters submitted for consideration.

Except as otherwise provide by law or by the company’s by-laws, resolutions of a general shareholders’ meeting are passed by a simple majority vote, abstentions and blank votes not being taken into account. Under the Corporation Law, the approval of shareholders representing at least one half of the issued and outstanding voting shares is required for the types of actions described below (as well as, in the case of clauses (i) and (ii) below, a majority of issued and outstanding shares of the affected class of preferred shares): (i) creating preferred shares or increasing an existing class of shares without observing the proportions of any other class of preferred shares, unless such an increase is authorized by the by-laws; (ii) changing a preference, privilege or condition of redemption or amortization of any class of preferred shares, or creating a new class of preferred shares that has a preference, privilege or condition of redemption or amortization superior to an existing class of preferred shares, (iii) creating founders’ shares; (iv) changing of the mandatory distribution of dividends; (v) changing the corporate purposes of the corporation; (vi) merging or consolidating the company, or spinning off certain of its business; (vi) winding up or liquidating the corporation; and (viii) participating in a “group of companies” as defined under the Corporation Law. The approval of the matters listed under clauses (i), (ii), (iv), (v) and (vii) above gives rise to shareholders’ withdrawal rights.

Shareholders’ meetings are normally called by the Board of Directors, provided that: (i) the Fiscal Board may call the annual shareholders’ meeting, if management retards for more than one month its call notice, and the special shareholders’ meeting whenever serious or urgent motives occur, by including in the agenda for the meeting the matters that it considers necessary; (ii) any shareholder may call the shareholders’ meeting if management retards for more than sixty days the call notice, in the cases provided for in the law and the by-laws; (iii) by shareholders representing at least five per cent of the capital stock, when the management does not meet, within the term of eight days, a request for a call duly grounded, with the indication of the matters to be deal with; (iv) by shareholders representing at least five per cent of the voting capital, or five per cent of the shareholders with no voting rights, when the management does not meet, within the term of eight days, a request for call notice of a meeting for installation of the Fiscal Board.
3.2. - What provisions guarantee minority shareholders the right to participate and vote in company meetings and shareholder ballots? Please explain the practical arrangements, including procedure, timetable and costs. What requirements are in place concerning whether shareholders’ voting rights are commensurate with their equity stake in the firm? What issues require mandatory shareholder approval (e.g., appointment or removal of directors, major corporate decisions such as mergers and acquisitions, sales of substantial assets; transactions with related parties)? Do they have the right to vote by proxy? Are there any restrictions as to who may be appointed a proxy? Is there any requirement for a proxy appointment to be notarized? Are there any other formalities such as lodging share scrip with the company in advance of the vote? Provide a commentary on the extent to which provisions are used, or where there may have been calls for reform by either domestic or overseas investors.

The Corporation Law adopts the principle that to each common share corresponds one vote with respect to matters submitted to a vote of shareholders at annual or special shareholders’ meetings. The law authorizes the By-laws to limit the number of votes of each shareholder, but the establishment of a plural vote (more than one vote per share) by any class of shares is prohibited. In practice, the possibility of limitation of the number of votes of each shareholder has not been applied.

Preferred shares normally do not entitle the holder thereof to vote at shareholders’ meetings, but shareholders may attend and address meetings of shareholders. The Corporation Law provides that non-voting shares acquire voting rights if a company, for a term set forth in its by-laws of no more than three consecutive years, does not pay the fixed or minimum dividend to which such shares are entitled and retain such voting rights until full payment of such dividends is made. Should preferred non-voting rights not provide for minimum or fixed dividends no voting rights are acquired.

Any proposal to change the rights, priorities, preferences and privileges of preferred shares, or to create a new class of shares with a right, priority, preference of privilege superior to the existing classes of preferred shares require the approval of the holders of a majority of the outstanding preferred shares, voting separately as a class, at a special meeting of holders of each such class of shares.

Mandatory Shareholder Approval. Shareholders voting at a general shareholders meeting have the exclusive power to (i) amend the by-laws, (ii) elect or dismiss members of the Board of Directors (and those of the Fiscal Board, if constituted) at any time, (iii) receive yearly accounts prepared by management and accept or reject management’s financial statements, including the allocation of net profits for payment of the mandatory dividend and allocation of the various reserve accounts, (iv) authorize the issuance of debentures, (v) suspend the rights of a shareholder who has not fulfilled his obligations imposed by law or the by-laws, (vi) accept or reject valuation of assets contributed by a shareholder in consideration for the issuance of capital stock, (vii) authorize the issuance of founders’ shares (partes beneficiárias), (viii) pass resolutions to reorganize the legal form of, merge, consolidate, spin-off, wind-up or liquidate the corporation, elect and dismiss its liquidators and examine their account, and (iv) authorize management to declare the corporation insolvent and request a concordata (a procedure involving protection from creditors similar in nature to a reorganization under the U.S. Bankruptcy Code).

Proxy Vote. A shareholder may be represented at a general shareholders’ meeting by a proxy appointed not more than one year before the meeting. The proxy must be a shareholder, a company officer or a lawyer. For public companies, the proxy may also be a financial institution. Under the Brazilian Civil Code, the signature of the principal on power-of-attorney must be notarized for purposes of enforceability against third parties. Should the power-of-attorney be executed abroad the notary seal must also be legalized at a Brazilian consulate, translated into Portuguese by a certified public translator and registered in the competent Registry of Deeds and Documents.

Other Formalities. There are no other formalities that may restrict the ability of the shareholders to attend or be represented at shareholders’ meetings.

1997 Reform. On May 5, 1997, an amendment to the Corporation Law (Law No. 9,457) was enacted. Such amendment, among other things, (i) entitles preferred shares of companies that do not provide for fixed or minimum dividend payments to receive dividends that are at least 10% greater than common share
dividends, (ii) allows a company's by-laws to establish that the redemption amount payable to dissenting shareholders can be lower than the net worth amount, if such redemption amount is calculated based on the economic value of the company; (iii) requires that compensation of the company's management be established at general shareholders' meetings; (iv) eliminates, in case of sale of the control of a company, the requirement that there be a mandatory public offer for the acquisition of the shares of minority shareholders; and (v) limits withdrawal rights in the case of mergers, consolidations or participation's of a company in groups of companies to dissenting shareholders (x) whose shares do not integrate general indexes representing share portfolios admitted for negotiation in future exchanges; and (y) of public companies where less than 50% of the shares (excluding the shares of the controlling shareholder) are held by the public. Also, if a merger, consolidation or spin-off involves a public company, the successor companies must also be public companies, and the non-compliance with such rule enables shareholders to withdraw from the company.

**Calls for Reform.** There have been calls to reform the Corporation Law to limit the ability of companies, public or private, to issue preferred non-voting shares. Such calls vary from the suggestion to simply extinguish preferred shares to a suggestion that the issuance of preferred non-voting shares be limited to fifty per cent of the total capital stock. Such calls have not mustered sufficient votes in Congress or obtained support of the Executive Branch of Government. As mentioned above, recently, however, Law 9457 of May 5, 1997 provided that preferred non-voting shares without a fixed or minimum dividend be paid dividends greater than ten per cent the dividend paid to common shares as a form of compensation for their not enjoying voting rights.

The Congress is currently reviewing several proposals that seek to amend the Corporation Law. The proposal that seems to have better chances of approval is a clean bill presented by congressman Emerson Kapaz which redrafts Bill No. 3,519 of 1997 of Congressman Luiz Carlos Hauly (the “Kapaz Clean Bill”). The Kapaz Clean Bill contains the following main proposals with regard to shareholders meetings and voting rights:

- the issue of preferred non-voting shares would be limited to 50% of the capital stock (the original version of the Bill presented by Congressman Hauly suggested the elimination of preferred non-voting shares);
- the term for publication of notices for a general meeting would be extended from 8 to 15 days for the first call and from five 5 days to 10 days for the second call;
- minority shareholders’ withdrawal rights in the event of a mergers and spin-off would be recreated, except for mergers and spin-offs approved as part of the Brazilian privatization program;
- preemptive rights could be excluded in the event of issues of shares for placement on offshore stocks exchange.

It seems that instead of reducing the ratio of voting to non-voting shares or eliminating preferred non-voting shares (which are valid instruments for structuring business transactions that in many circumstances not even involve public companies), the law should only limit or prohibit the primary distribution of preferred non-voting shares by public companies so that companies wishing to access the capital markets for funding purposes would be required to issue voting shares. An exception could be granted for preferred shares with fixed dividends, since those shares may be considered as a mezzanine instrument limited to very specific transactions.

**3.3. - What are the rights of shareholders to vote for the appointment or removal of the board of directors? Do shareholders have cumulative voting rights and if so under what circumstances?**

The Board of Directors must be composed of a number of members set forth in the by-laws (minimum of three members), appointed and removed by the shareholders’ meeting at any time. Shareholders representing at least one tenth of the voting capital stock may request the adoption of the cumulative voting system for the election of the directors. Under a cumulative voting procedure, each share is attributed as many votes as the number of directors, so that the shareholder may cumulate votes in a sole candidate or distribute them amongst various candidates. Cumulative voting rights must be exercised by 48 hours notice before the shareholders’ meeting. The number of votes necessary for the election of each director must be informed to the shareholders by the person that takes the chair of the meeting, based on the attendance book. In the event of a tie, a new cast is made to fulfill the position under the same cumulative voting procedure. The removal
of any director appointed under a cumulative voting procedure results in the removal of the remaining members and a new cast for appointment of the entire Board of Directors. If the number of directors is less than five, shareholders representing at least 20% of the voting capital stock have the right to appoint one director.

3.4. - How are shares registered and transferred? Is there any restriction upon voting rights relating to timetable, class or identification? Please comment upon the transparency, and reliability of the administration and provide examples.

The Corporation Law originally authorized the issue of registered, endorseable and bearer shares, providing, however, that bearer shares were not afforded voting rights unless converted into registered form. Endorseable and bearer shares were prohibited in 1990.

The ownership of registered shares is presumed by the inscription of the shareholder name in the “Registered Shares Register” book. The transfer of registered shares is made through an entry posted in the “Registered Shares Transfer” register, dated and signed by the assignor and the assignee, or their legal representatives. For the transfer of registered shares acquired on the stock exchange, the assignor is represented, regardless of a power-of-attorney, by the brokerage firm, or by the clearing agent before the stock exchange. Whilst a few public company shares with low liquidity in the stock market still maintain registered shares, most of the public companies shares, notably those with high liquidity have book-entry shares.

In order for the company’s by-laws for provide for the shares to be registered in book-entry form, its shares must be kept in deposit accounts at a financial institution accredited by CVM to provide the corresponding service, acting as a registrar for the shares. The transfer of book-entry shares is effected by an entry made by the registrar in its books, by debiting the share account of the transferor and crediting the share account of the transforee, against presentation of a written order of the seller, or judicial authorization or order, in an appropriate document which remains in the possession of the registrar. The company is liable for damages caused by mistakes or irregularities in the book-entry shares service, without prejudice to its right of recourse against the registrar.

Both the São Paulo Stock Exchange — BOVESPA and the Rio de Janeiro Stock Exchange — BOVESPA operate central clearing and custody systems through their respective affiliated companies, CBLC — Companhia Brasileira de Liquidação e Custódia and CLC — Câmara de Liquidação e Custódia S.A. A shareholder of a listed company may freely choose to participate in these systems. All shares put into the system are deposited in custody with the custodian through a Brazilian financial institution having a clearing account with the relevant system. The deposit in the custody system is reflected in the company’s register of shareholders, by means of the fiduciary transfer of record ownership to the custodian. Each participating shareholder, in turn, is registered in the register of beneficial shareholders of the company maintained by the custodian and is treated the same way as registered shareholders. Shareholders may also elect the custodial services of financial institutions accredited with the Central Bank of Brazil to render such services, rather than using the systems operated by the stock exchanges.

Both registrar services for book-entry shares and custodial services provided by clearing and custody systems of stock exchanges and accredited financial institutions have been reliable, there being no news of problems. The CBLC system has obtained a “no action” letter permitting investment companies registered under the United States Investment Company Act to be treated as an “eligible foreign custodian” for purposes of the Investment Company Act, and was also designated as an “approved depository” by the U.K. Securities and Futures Authority.

3.5. - What legal rights do shareholders have if these protections are violated? If regulatory bodies are responsible for protecting shareholder interests, what powers do those regulatory bodies have? Please provide examples of any recent successful or failed attempts to pursue redress.

As stated in the preceding paragraph, share registration system have proved to be reliable and we do not know of cases where problems have arisen.

3.6. - Are there derivative actions, oppression remedies, or other similar legal mechanisms
through which shareholders can act against controlling parties and management to protect the interests of shareholders?

The Corporation Law establishes that the Company is competent to bring civil liability action against the management, for losses caused to its property, upon prior resolution from the shareholders’ meeting. The resolution may be taken at the annual shareholders’ meeting, if provided for in the order of business, or, if as a direct consequence of the matter provided for in the order of business, at the special shareholders’ meeting. The administrators (directors or executive officers) against whom the action is brought shall be impeded and replaced at the same shareholders’ meetings. Any shareholder may bring the action if it is not brought within the term of three months as from the resolution by the shareholders’ meeting. Should the shareholders’ meeting resolve not to bring action, shareholders representing at least five per cent of the capital stock may bring action. In this case management remains in office, pending its resolution. The results of the action brought by the shareholders revert to the company, but the company must indemnify the shareholders, up to the limit of such results, of all expenses incurred, plus interest and monetary correction. This action, referred to as social action, does not exclude any individual action by the shareholder or third party directly harmed by the administrator act.

The controlling shareholder is liable for damages caused by acts performed with abuse of power. The concept of abuse of power involves a number of conducts, such as (i) to orient the company to an aim different from the corporate purposes or harmful to national interests, to favor other Brazilian or foreign companies to the detriment of the interest of minority shareholders in the profits or properties of the company or to the interest of national economy; (ii) promote the liquidation of a prosper company, or the transformation, merger, consolidation or spin-off of the company, with an aim of obtaining for its own benefit of for the benefit of others, an undue advantage, to the detriment of the remaining shareholders, of the company’s workers or investors in the company’s securities, (iii) to promote an amendment to the by-laws, issuance of securities, or adoption of policies and decisions contrary to the company’s interest and aimed at causing loss to minority shareholders, company’s workers or investors in the company’s securities; (iv) elect administrator (director) or member of the Fiscal Board knowing that the person is moral or technically inapt; (v) induce, or attempt to induce, administrators or members of the Fiscal Board to practice illegal act or promote, in breach of the legal and statutory duties and against the company’s interest, its ratification by the shareholders’ meeting; (vi) contract with the company, directly or through others in favored conditions or not in arms’ length; (vii) approve or cause irregular management accounts to be approved, for personal favor, or abstain from investigating denunciations which he knows or should know to be substantiated, or that justify grounded suspicion of irregularity; (viii) subscribe for shares in a capital increase, with payment in properties strange to the company’s corporate purposes. The action for reparation of damage caused by the controlling shareholder may be brought by shareholders representing five per cent or more of the capital stock or by any shareholder, in the latter case provided that a bond is placed to secure procedural costs and attorney fees due in the event the action is denied.

Right of Withdrawal and Redemption. Another remedy provided by the Corporation Law is the right of withdrawal and redemption. A dissenting shareholder has the right to withdraw from the company through redemption upon a decision made at a shareholders’ meeting (i) to create a class of preferred shares or to increase an already existing class of shares without maintaining its ratio to the other classes of preferred shares, unless such action has been previously authorized by the by-laws, (ii) to change the preference, advantages or conditions of redemption or amortization of one or more series of preferred shares or to create a class of shares having priority or preference over existing preferred shares, (iii) to modify the mandatory distribution of dividends, (iv) to change the corporate purposes of the company, (v) to dissolve or liquidate the company, (vi) to transfer all of the shares of the company to another company in order to make the company a wholly-owned subsidiary of such other company (incorporação de ações), to consolidate the company with another company for the purpose of creating a new company (fusão) or to transfer part or all of the company’s assets to another company, either with the dissolution of the company or with a split of its capital (cisão), or (vii) to approve the acquisition of another company the purchase price for which exceeds certain limits, set forth in the Corporation Law. The right to claim redemption lapses 30 days after publication of the minutes of the relevant shareholders’ meeting. The company is entitled through a general meeting called within ten days after the expiration of such right to reconsider any action giving rise to redemption rights if the redemption of shares by dissenting shareholders would jeopardize the financial stability of the corporation. In the cases mentioned in the preceding paragraph, the shares are redeemable at
their book value, determined on the basis of the last annual balance sheet approved by the shareholders. If the shareholders' meeting giving rise to redemption rights occurs more than 60 days after the date of the last annual balance sheet, a shareholder may demand that its shares be valued on the basis of a new balance sheet that is as of a date within 60 days of such shareholders' meeting. On May 5, 1997, an amendment to the Corporation Law (Law No. 9,457) was enacted. Such amendment, among other things, allows a company's by-laws to establish that the redemption amount payable to dissenting shareholders can be lower than the net worth amount, if such redemption amount is calculated based on the economic value of the company, which could be based on forecast profits assessed through a discounted cash flow valuation or other criteria set forth in the by-laws.

3.7. - Explain the formal powers of other capital providers and stakeholders, for example, creditors, employees, bankers, government. Provide a commentary on how these function in relation to shareholder rights. Please give examples to illustrate how these operate.

Creditors may oppose capital reductions where payments are to be made by shareholders and mergers where their interests are harmed.

Other capital providers and stakeholders, such as creditors, employees, bankers and the government, provided that directly harmed by the act, have action against the company, the controlling shareholder or the administrator based on the guiding legal principle of civil liability provided for in Article 159 of the Civil Code, that states that “anyone who, by commission or voluntary omission, negligence or imprudence, violates the right or causes harm to another is obliged to make reparation for such damage.”

3.8. - Please provide your own comments upon any areas which require reform, drawn from your expertise in the field, or the opinion of others active in the market.

Under the existing legislation the acquiror of control of a public company has no obligation to conduct the acquisition through public trade on a Stock Exchange or to make a tender offer to minority shareholders to enable them to exit from the company. The absence of a legislation that requires a mandatory tender offer for all public shareholders is probably one of the most controversial issues in Brazil.

While some groups argue that the controlling shareholder has duties and obligations under the corporate law and therefore should be entitled to the full premium of control paid in the acquisition of control, the absence of such mandatory tender offer has been widely criticized as key deterrent to the development of the Brazilian stock market since investors are not assured the right to exit the company in the event of a change of control.

In practice, such right has never been fully recognized in Brazil, since CMN Resolution No. 401 restricted the mandatory tender offer provided for in Article 254 of the Corporation Law to holders of voting shares, and in most of the cases such shares have a minor free float in the Brazilian market.

Not only Article 254 was repealed by Law 9,457, but a number of public companies which control has been privately sold to transnational companies headquartered abroad have immediately thereafter made tender offers with the intention to buy-back common and preferred shares. Minority shareholders have argued that such transactions have virtually obliged them to sell their shares to the new controlling shareholders with losses, under penalty of becoming shareholders of a company with no liquidity at all.

The Kapaz Clean Bill contains the following proposals in this respect:

- should the controlling shareholder wish cause the company to go private or resolve to make a tender offer which may result in a free-float lower than 20% of the capital stock, the controlling shareholder would be required to make a tender offer to minority shareholders. The tendered price should not be lower than the redemption amount calculated in accordance with the Corporation Law;
- the mandatory tender offer to minority shareholders holding voting shares in the event of change in control would also be recreated. The law would establish that the price tendered should be equal to at least 85% to the price paid to the former controlling shareholder. This provision would not be applicable to sales including in the Brazilian privatization program.
We believe that these proposal does not achieve an equitable treatment to minority shareholders while maintaining the rights of controlling shareholders. It seems that the existing rules do not provide for a fair and efficient set of rules for protection of the interests of both minority and majority shareholders in a change of control. Nevertheless, as the discussion is solely focused in the tender offer, it has failed to consider other related issues such as the absence of appraisal rights (a remedy created by certain U.S. state corporation statutes that gives minority shareholders the right to seek a judicial determination as to the “fair price” of their shares in the event of a merger), and the fact that there is no legal mechanism that authorizes the acquiror of control of a public company to squeeze out minority shareholders should dissenting shareholders (which in a number of cases represent an insignificant interest) insist in maintaining their shares after a merger is consumated or the acquired company is delisted.

4.0 Oversight of management

4.1. Describe the structure and powers of the ultimate body governing the corporation. Explain how this body, such as the board of directors, or supervisory board, exerts its oversight role in relation to the management. Explain how members are appointed and removed, and specify where such powers reside (for example, investors, employees, auditors, the state). Are there any minimum criteria for appointment? May non-residents or foreigners be appointed?

Corporation Law requires that management of public companies be incumbent on a Board of Directors (Conselho de Administração) and an Executive Board (Diretoria). The creation of a Board of Directors is not mandatory for private companies with no authorized shares (shares that may be issued by the Board of Directors without shareholder approval), which may have only an Executive Board.

The Board of Directors is the decision-making body of the company. The Board of Directors is responsible for determining the basic guidelines and policies of the company, establishing the corporate strategy, reviewing business plans, supervising and monitoring the activities of the Executive Officers, and implementing and supervising internal audits. Its members, the Directors (Conselheiros de Administração), do not perform executive functions.

The Executive Board is the executive management body of the company. The Executive Board is responsible for the day-to-day management of the company and the implementation of the general guidelines and policies established by the Board of Directors. Its members, the Executive Officers (Diretores) are vested with exclusive power to act on behalf of the company.

Member of the Board of Directors are appointed and removed by majority vote of the shareholders, cumulative vote being permitted (see item 3.3 above). When the company has a Board of Directors it appoints or removes the Executive Board. Otherwise, the Executive Board is appointed or removed directly by the shareholders.

On April 8, 1999, President Cardoso enacted Provisional Measure 1754-16/99, introducing, among other things, an amendment to article 146 of Law 6404/76 the Corporation Law, so as to permit the appointment of individuals resident abroad to the Board of Directors of Brazilian companies. Directors that reside abroad must in turn appoint an attorney-in-fact resident in Brazil, with powers to receive service of process regarding claims based on corporate laws. The term of validity of such power of attorney must equal the term of office of the Director of the company. Provisional Measures must be reissused on a monthly basis to maintain their effectiveness prior to being accepted by Congress (and converted into a law) or refused by Congress.

4.2. Are there legal duties owed by the members of the governing body of the corporation? To whom are these duties owed? How are they enforced? Are there legal liabilities? Does the securities regulator or the court have power to disqualify or sanction directors for non-performance? Please provide examples to illustrate the extent to which any duties are honoured or breached in practice.

The Duty of Diligence, Loyalty and Confidentiality. An administrator holds a position of trust and it is obligated to serve the company diligently and loyaly, keeping its dealings confidential and holding secret any facts not disclosed to the market. Such administrator is prohibited from availing himself of privileged
information in order to obtain for himself or others any advantage with regard to dealing with securities. Controlling shareholders of public companies are also bound by the very same principles.

**Duty to Inform.** Administrators of public companies are obligated to provide the following information regarding trading with securities issued by the company:

- (a) upon signing the instrument of investment in the position of administrator, state the number and characteristics of any securities issued by the company, controlled companies or those of the same group, which they hold or for which they have a purchase option;

- (b) trading carried out, types of transactions and other information regarding the abovementioned securities owned by the administrator or his spouse, companion or any other dependent included on his income tax return;

- (c) to shareholders in annual general meeting, the number of securities issued by the company, controlled companies or companies in the same group, acquired or disposed of by the administrator either directly or through third parties, any options for the purchase and sale of shares contracted or exercised during the previous year, and any material acts or facts, when requested by shareholders representing at least 5% (five percent) of the share capital; and

- (d) to the market, stock exchanges and CVM, any material acts or facts.

The controlling shareholders of publicly-held companies must also provide the information mentioned in item (a) above, upon acquisition of control of the company, and in item (b), within ten days of the end of the month in which the securities were traded.

**Surveillance.** They are supervised directly by the shareholders. In addition, they are subject to the supervision of CVM in the case of public companies. The CVM has legal authority to apply penalties, which may be admonishment, fines or suspension or prohibition to act as administrator of public companies.

4.3. - Describe any legal requirements as to the board structure and composition. Are there any requirements for the inclusion of specific committees on the board? Are there any regulations regarding the membership of those committees?

The Board of Directors must be composed of a number of members set forth in the by-laws (minimum of three members), appointed and removed by the shareholders’ meeting at any time. The Executive Board must be composed of a number of members set forth in the by-laws (minimum of two members), appointed and removed by the Board of Directors.

Persons appointed for the Board of Directors or the Executive Board may not be disqualified by special law or sentenced for a bankruptcy offence, fraud, bribery or corruption, misappropriation of public funds or embezzlement, crimes against the national economy or decency or public property, or to any criminal sanction which precludes, even temporarily, access to public office. A person who has been declared by CVM not to be qualified is also ineligible for election to an administrative office in a public company.

The Corporation Law permits the creation of technical and advisory bodies in the by-laws of Brazilian companies, and establishes that members of such bodies have the same duties and responsibilities of the management. Nevertheless, there are no requirements for inclusion of specific committees on the Board of Directors, and only a few companies have created board committees, such as executive compensation committees.

Due to former restriction on the appointment of individuals resident abroad to the Board of Directors of Brazilian companies (recently repealed by Provisional Measure 1754-16/99), a number of companies have created Advisory Boards in order to afford the participation of non-residents as management advisors. It is expected that such Advisory Boards will lose part of their attractiveness with the elimination of legal restrictions on the appointment of non-residents to the Board of Directors.
4.4. - How independent oversight of the management is conducted in practice, and in particular in relation to financial reporting, internal controls? What mechanisms are in place to ensure effective oversight of the audit function?

The principal body charged with independent oversight of the management is the Fiscal Board (Conselho Fiscal). Differently from an U.S. audit committee, the Fiscal Board in Brazil is a corporate body independent of a company’s management and external auditors. Its primary responsibility is to review a company’s financial statements and report them to shareholders. When installed, its opinion is required on certain matters, such as proposals for capital increase, issuance of securities, and mergers, spin-offs or consolidations by the company. Under the Corporation Law, public companies are required to provide in their by-laws for the existence of a Fiscal Board, but such Board is not required to be maintained or installed on a permanent basis.

Shareholders representing 10% of the voting shares or 5% of any class of non-voting shares may request the installation and maintenance of a Fiscal Board. The Fiscal Board may be composed of three to five members, as stated in the company’s by-laws, with the same number of alternates. Holders of preferred non-voting shares, voting separately as a class, are entitled to elect one member and his alternate by majority vote; minority shareholders representing at least 10% of the voting shares are entitled to elect one member and his alternate; and holders of remaining voting shares are entitled to elect the other members and their respective alternates.

Persons elected to serve on the Fiscal Board need not be shareholders, but must be residents of Brazil and either hold a university degree or have served as an officer of Fiscal Board member of a corporation for at least three years.

The recently enacted CVM Instruction No. 308, which regulates accreditation of independent accounts with CVM, included, among the duties and responsibilities of the independent accountants, the duty to verify:

- if the financial statements and the audit opinion were published in the newspapers of mandatory publication; and
- if the allocation of results of the entity are in compliance with corporate law, the by-laws and the CVM regulations.

Any material irregularity must be communicated to CVM in writing within 20 days as from the date of occurrence.

The auditor must also communicate CVM any material irregularity relating to internal controls and accounting procedures of the audited entity and any noncompliance with legal laws and regulations applicable to the activities of the company or relating to its condition as securities market participant that may have material impact on the company’s financial statements of operations.

A few companies such as the airline Varig have also experimented the creation of an audit committee within the Board of Directors (inspired in the U.S. model), in addition to the Fiscal Board provided for in the Corporation Law.

4.5. - Explain the process for nominations to the governing body and removal of members. What recommendations or requirements are in place regarding inclusion of independent members that are not part of management? How is independence defined? Are independent directors given special responsibilities (e.g. membership of the audit committee)? Please provide examples of how the system works, formally and in practice.

There are legal no legal recommendation or requirement regarding inclusion of independent members that are not part of management, but the Corporation Law establishes that a maximum number of one third of the Board of Directors may be elected for the Executive Board. Apparently, such threshold would produce an independent Board of Directors, but in practice there is no prohibition that company’s officers with no seat in the Executive Board be nominated to the Board of Directors. For a commentary on the process for nominations to the Board of Directors and the Executive Board please refer to answers to items 3.3 and 4.3.
The IBGC Code contains recommendations for inclusion of independent members in the Board of Directors (see Appendix III).

4.6. - Please provide a commentary on the strengths and weaknesses of the current law, regulation and informal standards which govern the practical oversight of management. Please offer your views on areas for reform, and any current debate within the country on how this might be taken forward, referring to legal, regulatory and voluntary standards.

Despite the existence of a reasonable set of corporate governance principles and regulations which govern the oversight of management, in practice the ownership model that prevails in Brazil resulted in Boards of Directors and Fiscal Boards that generally do not exercise their formal duties, responsibilities and powers with the expected diligence and care. Members of the Board of Directors and the Fiscal Board meet sporadically and do not devote sufficient time to their responsibilities. In practice, management is exercised by the Executive Board with the oversight of the controlling shareholder (in case such shareholder is not the chief executive officer himself).

Until the ownership model of Brazilian public companies does not evolve at least to a dominant control model in which a group of investors share the control the legislation could improve minority shareholders rights in the process for nominations to the Board of Director and the Fiscal Board.

The Kapaz Clean Bill contains the following proposals:

- the installation of the Fiscal Board on a ongoing basis would be mandatory for public companies, and the controlling shareholder would be prohibited from electing the majority of its members, provided that minority shareholders own at least 5% of the voting stock;
- preferred shareholders would have the right to appoint and remove one member of the Board of Directors.

Depending on the ownership structure of the company, the approval of the proposal for the Fiscal Board could give a minority shareholder with a 5% voting interest a voting right which would not be commensurate with his equity stake in the firm. An alternative proposal: preferred shareholders would have the right to vote at the election of the Fiscal Board.

While changes in the legislation such as those included in the Kapaz Clean Bill may contribute to a certain extent to an improvement, standards of practical oversight of management will only evolve as the shareholder activism develops and the internationalization of the Brazilian capital market goes forward.

São Paulo, December 31, 1999

Antonio Mendes

Henrique Silva Gordo Lang
### APPENDIX I

**LIST OF COMPANIES THAT COMPOSE THE BOVESPA INDEX (IBOVESPA)**

(Effective from May to August 1999)

<table>
<thead>
<tr>
<th>Floor Name - Code</th>
<th>Activity Sector</th>
<th>Investor Relations Officer</th>
<th>Headquarter’s Address – ZIP Code - City/State - Phone</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Aracruz - ARCZ</strong></td>
<td>Pulp and Paper</td>
<td>Agilio Leão de Macedo Filho</td>
<td>Rua Lauro Muller, 116, 22 floor, 22290-160 - Rio de Janeiro, RJ. (5521)545-8111</td>
</tr>
<tr>
<td><strong>Banespa - BESP</strong></td>
<td>Multiple Banks</td>
<td>Ariovaldo D’Angelo</td>
<td>Praça. Antônio Prado, 6, 01010-010 - São Paulo, SP. (5511) 259-6622</td>
</tr>
<tr>
<td><strong>Bradesco - BBDC</strong></td>
<td>Multiple Banks</td>
<td>Luís Carlos Trabucco Cappri</td>
<td>Cidade de Deus, s/No., 06029-900 – Osasco, SP. (5511) 7084-5376</td>
</tr>
<tr>
<td><strong>Brahma - BRHA</strong></td>
<td>Beer and Soft Drinks</td>
<td>Luís Felipe Pedreira Dutra Leite</td>
<td>Rua Marques de Sapucai, 200, 2015-900 - Rio de Janeiro, RJ. (5521)503-9393</td>
</tr>
<tr>
<td><strong>Brasil - BBAS</strong></td>
<td>Commercial Banks</td>
<td>Carlos Gilberto Gonçalves Caetano</td>
<td>Setor Bancário Sul, Ed. Sede III, 24 floor, 7089-900 – Brasília/DF (5561) 310-2335</td>
</tr>
<tr>
<td><strong>Brasmotor - BMTO</strong></td>
<td>Home Appliances</td>
<td>Nelson Gustavo Manischk</td>
<td>Av. Brigadeiro Faria Lima, 1478, 18 floor, 01452-001 - São Paulo/SP. (5511) 3039-5410</td>
</tr>
<tr>
<td><strong>Celesc - CISC</strong></td>
<td>Electric Power</td>
<td>Enio Andrade Branco</td>
<td>Rodovia SC 404, Km 3, 88034-900 – Florianópolis, SC. (5548) 231-6030</td>
</tr>
<tr>
<td><strong>Cemig - CMIG</strong></td>
<td>Energia Eléctrica Electric Power</td>
<td>Djalma Bastos de Morais</td>
<td>Av. Barbacena, 1200, 30190-131 – Belo Horizonte, MG. (5531) 349-2111</td>
</tr>
<tr>
<td><strong>CESP - CESP</strong></td>
<td>Electric Power</td>
<td>Celso Arras Minchillo</td>
<td>Al. Ministro Rocha Azevedo, 25, 13 floor, 01410-900 - São Paulo, SP. (5511) 252-3505</td>
</tr>
<tr>
<td><strong>Copene - CPNE</strong></td>
<td>Petrochemical Industry</td>
<td>Wong Kwong Shin</td>
<td>Rua Eteno, 1561, Complexo Básico, 42810-000 – Camaçari, BA. (5571) 832-5102</td>
</tr>
<tr>
<td><strong>Copesul - CPSL</strong></td>
<td>Petrochemical Industry</td>
<td>Regis Lemos deAbreu</td>
<td>BR 386, Rodovia Tabai/Canoas, Km 419, Lote 23, 95853-000 – Triunfo, RS. (5551) 457-1100</td>
</tr>
<tr>
<td><strong>Duratex - Dura</strong></td>
<td>Wood</td>
<td>Plínio do Amaral Pinheiro</td>
<td>Av. Paulista, 1938, 5 floor, 01310-200 - São Paulo, SP. (5511) 3179-7359</td>
</tr>
<tr>
<td><strong>Ebe - EBEN</strong></td>
<td>Electric Power</td>
<td>Otávio Carneiro Rezende</td>
<td>Av. Alfredo Egídio de S. Aranha, 100, bloco C, 11 floor, 04726-170 - São Paulo, SP. (5511) 546-1077</td>
</tr>
<tr>
<td>Floor Name - Code Name of Company</td>
<td>Activity Sector</td>
<td>Investor Relations Officer</td>
<td>Headquarter's Address – ZIP Code - City/State - Phone</td>
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</tr>
<tr>
<td>Eletrobrás - Elet Centrais Eletr. Bras. S/A Eletrobrás</td>
<td>Electric Power</td>
<td>Paulo Roberto Ribeiro Pinto</td>
<td>Rua Dois, Edifício Petrobrás, 4 floor, 70040-903 - Distrito Federal, DF (5561) 321-4186</td>
</tr>
<tr>
<td>Gerasul - GRSU Centrais Gerad Sul Brasil S/A</td>
<td>Electric Power</td>
<td>Laércio Dias</td>
<td>Rua Deputado Antonio Edu Vieira, 999 88040-901 – Florianópolis, SC. (5548) 231-7252</td>
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<td>Inepar - INEP Inepar S/A - Indústria e Construções</td>
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<td>Av. Juscelino Kubitscheck de Oliveira, 11.400, 81450-900 – Curitiba, PR. (5541) 341-1212</td>
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<tr>
<td>Itaúbano - ITAU Banco Itá S/A</td>
<td>Multiple Banks</td>
<td>Alfredo Egydio Setubal</td>
<td>Rua Boa Vista, 176, 01092-900 - São Paulo, SP. (5511) 608-8700</td>
</tr>
<tr>
<td>Klabin - KLAB IKPC - Indústrias Klabin de Papel e Celulose S/A</td>
<td>Pulp and Paper</td>
<td>Carlos Alberto Bifulco</td>
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<td>Paul F Luz - PALF Cia. Paulista de Força e Luz</td>
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<td>Petrobrás BR - BRDT Petrobrás Distribuidora S/A</td>
<td>Fuel Distributors</td>
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</tr>
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<td>Sid Tubarão - CSTB Cia. Siderúrgica de Tubarão</td>
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<td>Floor Name - Code</td>
<td>Activity Sector</td>
<td>Investor Relations Officer</td>
<td>Headquarter’s Address – ZIP Code - City/State - Phone</td>
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<tr>
<td>Teles RCTB - RCTB</td>
<td>Telecommunications</td>
<td>Receipt of shares of 12 companies resulting from the Telebras spin-off</td>
<td>(5521) 849-9177</td>
</tr>
<tr>
<td>Telepar - TEPR</td>
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</tbody>
</table>
APPENDIX II

CONTACT LIST FOR LEGAL, REGULATORY AND BEST PRACTICE BODIES CHARGED WITH DEVELOPING, IMPLEMENTING, MONITORING AND ENFORCING CORPORATE GOVERNANCE STANDARDS FOR LISTED COMPANIES

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APPENDIX III

BRAZILIAN INSTITUTE OF CORPORATE GOVERNANCE

CODE OF BEST PRACTICE

In general the codes of best practice focus on the board of directors. Corporate governance, however, includes the owners, the board of directors and its committees, the chief executive officer, the independent auditors and the fiscal board. This code will be expanded to cover all actors within corporate governance.

The “Top Management Summit” held at Itu, SP, on April 10-12, 1997, developed a number of positions related to corporate governance. Based on these the Dom Cabral Foundation edited a document titled “Governança Corporativa, Subsídios ao Código Brasileiro de Melhores Práticas”. Some of these suggestions have been considered in the present code.

THE BOARD OF DIRECTORS

The Mission of the Board of Directors

The mission of the board of directors is to maximise shareholder value.

The board of directors should pursue the objectives, values and beliefs of the shareholders.

The authority of the board of directors

Article 142 of the Company Law determines the authority of the board of directors. Special emphasis should be given to strategy formulation, election and dismissal of officers, supervision and control of management, and election and dismissal of independent auditors.

The activities of the board of directors should be specified in writing clarifying its authorities and responsibilities in order to avoid conflicts with the chief executive officer.

The board of directors should stimulate the creation of a formal code of ethics for the company.

The board of directors, having access to any company information, should avoid getting involved in operating matters of the company.

Committees of the board of directors

Many of the activities of the board of directors need detailed analysis that is not possible to do during the board meetings. Committees should therefore be formed with a few board members each, for example, committees for nominations, audit, remuneration etc. Each committee studies its area and prepares proposals for decisions. Only the full board of directors can made decisions.

Independent auditors

The board of directors, or its audit committee (if existing), negotiates with the independent auditors in order to establish the scope of the audit, time schedule and price.

The size of the board of directors

The size of the board of directors should be as small as possible, and, depending on the requirements of the company should vary between 5 and 9 members.
Executive session of the board of directors

It is the function of the board to evaluate officers and management. Regularly scheduled executive sessions among the external and the independent board members should be held as a matter of course, thus disarming concern over an action that may otherwise be perceived as unusual and threatening.

Participation of non-members in the board meetings

Key company personnel may occasionally be invited to a board meeting in order to make presentations of their activities.

Evaluation of the board and the individual board member

Every year there should be a formal evaluation of the performance of the board as a whole and of each individual board member. The evaluation system should be adapted to the needs of each company.

THE BOARD MEMBER

Personal characteristics of the board member

Each board member should have
- personal integrity,
- capacity to read and understand financial statements,
- absence of conflicts of interests with the company,
- time availability, and
- motivation.

Core competencies of the board of directors

The following experiences and competencies should be available among the members of the board of directors:
- experience from good boards,
- experience as chief executive officer,
- experience of crisis management,
- knowledge of finance,
- knowledge of accounting,
- knowledge of the industry of the company,
- knowledge of the international market,
- strategic vision,
- contacts of value for the company.

The board should have a diversity of background, knowledge and experience.

The majority of the board members should be independent (for definition of independence, see below).

Length of service

The length of service should be defined. The term should be short, varying between one and three years. Re-election should be possible after a formal-performance evaluation. Re-election should not be automatic.

Age limit

Some people are unproductive long before they reach 60 years of age. Others are very productive at 75. If the term is short, and the formal performance evaluation efficient, there is no reason for having an age limit.
Change of occupation of the board member

The main occupation of the board member is often an important factor in his or her recruitment. When there is a change in the main occupation, the board member should resign. The nominating committee should analyse the convenience of a re-election.

Remuneration

The board member should be remunerated based on the time dedicated to the company. His or her hourly rate should be comparable with the theoretically calculated hourly rate of the chief executive officer.

Independent advice

The board member should have the possibility to get independent advice from external professionals (lawyers, auditors, tax specialists etc) to be paid by the company in order to obtain a second opinion. The board should prepare a written instruction for independent advice.

INDEPENDENCE

The fundamental reason for the importance of independence is to avoid conflict of interests.

Independent board member

A majority of the board members should be independent. A board member is independent if he or she

- has no link to the company besides the board position and the possession of shares of the company,
- has never been employed by the company or any of its subsidiaries or associate companies,
- provides no services or products to the company,
- is not employed by any firm providing major services or products to the company,
- is not the spouse or first and second degree relative to any officer, manager or the ultimate controller of the company,
- is not receiving any compensation from the company other than board remuneration and dividends if shareholder.

The board member should work for the good of the company and consequently for all the shareholders. The board member should try to maintain maximum independence from the shareholder, shareholding group or interested party who might have indicated him or her for board membership.

Classes of independence

There are three classes of board members:

- independent (see definition above),
- external (board members who do not work in the company but who are not independent),
- internal (board members who are employed by the company or its subsidiaries).

The board of directors supervises and controls the officers of the company. It is a typical situation of conflict of interest if you supervise and control yourself. Consequently, one should avoid situations when the same person is both officer and board member.

Chairman of the board and chief executive officer

One should try to avoid situations when the same person is the chairman of the board and chief executive officer. The logic here is the same as the case above when the same person is both officer and board member.

Lead director
In the case when the chairman of the board and the chief executive officer is the same person it is vital that there is a strong independent board member who is respected by his colleagues and by the industry and who can serve as a lead director to counterbalance the power of the chairman/CEO.

TRANSPARENCY AND DISCLOSURE

The shareholders has the right to get timely and transparent information about the company in which they have invested.

The efficiency of the capital market depend on transparent information on their listed companies.

Spokesman of the company

The board of directors should designate one only person to serve as the spokesman of the company in order to avoid the risk of having contradictions between declarations by the chairman, the chief executive officer and others. The executive who serves as a liaison with the capital market has powers delegated from the spokesman.

Balanced information

The information distributed by the company should be balanced. They should cover both good and bad news in order for the reader to be able to evaluate the company correctly.

Truthful information

The board of directors and the spokesman of the company has to make sure that the information to the shareholders and the capital market is truthful. The company may suffer punishment for false information.

Evaluation system

The system for the evaluation of the board of directors, the individual board members, the chief executive officer and the officers should be explained in the annual report.

Shareholdings and remuneration of the board members and the officers

Many foreign codes of best practice recommends that the number of shares and the remuneration of each board member and officer be made public in the annual report.

Corporate governance practices

The annual report should inform about which code of best practice has been used by the company and explain any deviation by the company from said code.

BOARD PROCESSES

Evaluation of the chief executive officer

The board of directors should annually made a formal performance evaluation of the chief executive officer.

Succession planning

The board of directors should always have an up-to-date succession plan for the chief executive officer and other key personnel.

Introduction of new board members
Each new board member should be exposed to an introduction program including a board file with a job description for board members, the last annual reports, the minutes from ordinary and extraordinary general assemblies, the minutes from the board meetings, and other information about the company. The new board member should be introduced to his or her colleagues, to the officers and to key personnel. There should be visits to factories and other places of business. Depending on the type of company additional training should be included.

MEETINGS OF THE BOARD OF DIRECTORS

Documentation for the meetings

The effectiveness of the board meetings depend to a great extent on the documentation distributed to the board members prior to the meeting. The proposals for decisions should be formulated. The documentation should be in the hands of the board members well ahead of the weekend prior to the meeting. Each board member should read the documentation carefully and be well prepared for the meeting.

Agenda

The agenda for the board meeting should be prepared by the chairman also considering suggestions from board members and officers.

Minutes of the board meetings

It is important to have a good secretary for the board meetings. All decisions should be registered. It is important that the minutes reflect the spirit and the letter of the proceedings. Board members should read the minutes with attention.
APPENDIX IV

DESCRIPTION OF CONCORDATA AND FALÊNCIA PROCEEDINGS

I. CONCORDATA PROCEEDINGS

The Brazilian Bankruptcy Law provides for two distinct legal proceedings which may significantly impact the recovery rights of creditors: concordata and falência. Concordata is a defensive remedy which provides a mechanism for troubled companies to obtain partial debt forgiveness while remaining in control of its ongoing operations. Concordata proceedings may be preventive (when filed voluntarily by the Company before bankruptcy proceedings, or falência proceedings, are initiated) or suspensive (when filed during the course of falência proceedings brought against the Company by its creditors). If applicable, concordata proceedings will allow a commercial debtor to have part of its unsecured debt extinguished or, at least, obtain a deferral of a payment obligation. On the other hand, falência proceedings are a conventional bankruptcy process analogous to a Chapter 7 proceeding under the U.S. Bankruptcy Code, which result, unless a suspensive concordata is successfully invoked, in the liquidation of the company's assets under court supervision. Neither of these proceedings afford a troubled company the opportunity to reorganize its operations in a manner similar to that provided under Chapter 11 of the U.S. Bankruptcy Code.

A. INITIATION OF CONCORDATA PROCEEDINGS

Concordata proceedings may only be initiated by the debtor. The Bankruptcy Law determines that a company electing to file for a preventive concordata must submit a proposed plan of repayment to a bankruptcy court, which will, in turn, present the plan to the company's creditors and a special referee (the "Comissário") for their consideration. In order to have its petition granted, the company must produce evidence that its financial situation will allow it to satisfy the reduced or rescheduled payments under its proposed repayment plan.

Upon reviewing the plan, the Comissário will submit to the bankruptcy court a detailed report which usually contains (i) an analysis of the company's financial situation, including the causes of its financial difficulties, (ii) any guarantees underlying the company's indebtedness, (iii) the company's conduct before and after the petition for concordata, and (iv) the likelihood that the company will be able to fulfill its financial obligations under concordata. Based on the Comissário's report, the bankruptcy court will decide to either grant or deny the company's petition for concordata. In general, judges are lenient about granting such protection.

A company's unsecured creditors may oppose the petition for concordata and, consequently, the proposed repayment plan under one or more of the following conditions: (1) the proposal does not satisfy the statutory requirements described in Section B below; (2) the proposed repayment plan is not feasible; or (3) the loss to the creditor from payments made under the proposed repayment plan would be greater than the loss to the creditor from a pro rata distribution under a liquidation of the company's business.

B. ELIGIBILITY FOR CONCORDATA PROCEEDINGS

2 Brazilian law distinguishes between comerciantes (businessmen)—individuals engaged in trade and in industrial and commercial enterprises—and professionals and private persons. Concordata is only available to comerciantes, as is bankruptcy (or falência) under the Bankruptcy Law. Professionals and private persons are not covered by the Bankruptcy Law but are subject to a concurso de credores, which is governed by civil law. Brazilian Civil Code, Articles 1554—1571 (Law No. 3071, of January 1, 1916, as amended) and Brazilian Code of Civil Procedure, Articles 748—786 (Law No. 5869, of January 11, 1973, as amended). Brazilian corporations (sociedades anônimas) will always, regardless of their social objectives, be considered commercial by their nature and, therefore, be subject to concordata and falência.

3 Falência proceedings are discussed in more detail below.

4 Bankruptcy cases in Brazil are handled by State Court Judges. For the purposes of this Appendix, the term "bankruptcy court" will refer to the State Court with jurisdiction to conduct concordata or falência proceedings against a relevant debtor company.

5 The special referee, or Comissário, will be selected either from among the filing company's unsecured creditors or from a panel of professional referees. Bankruptcy Law, Article 161.

6 The reason for the existence of concordata proceedings, as an alternative to falência proceedings, is to allow debtors to reschedule or obtain partial forgiveness of their debt while maintaining control over their operations. In order to benefit from this alternative, however, debtor companies must prove their ability to meet the rescheduled payments.

7 The Comissário will act on behalf of the creditors as an overseer of the debtor with respect to concordata proceedings. Bankruptcy Law, Article 169, item X, letter "â."
In addition to the requirement that it must produce evidence that its financial situation will allow it to satisfy the reduced or rescheduled payments, a Brazilian company seeking to file for concordata must meet the following eligibility requirements: (1) it must possess assets worth more than 50% of its unsecured debts; (2) it must have been in business for at least two years; (3) it must not have filed for concordata relief within the preceding five years; (4) it must have complied with the terms of any previously granted concordata decree; (5) it must not have been found guilty of a bankruptcy crime; and (6) it must have duly filed all applicable records with the appropriate board of trade. In addition, a Brazilian company may not file for concordata if an official protest has been filed against the company for the failure to pay a debt, although this requirement is often waived by Brazilian courts.

C. EFFECT OF CONCORDATA ON CREDITORS

Once granted by a Brazilian court, the concordata decree binds all general, unsecured creditors of the company. Secured creditors are not directly affected by the concordata proceedings and, consequently, are not prevented from either suing the company to collect their claims or foreclosing on their security interests in separate proceedings. In addition, unsecured creditors are not barred by the concordata proceedings from pursuing any guarantee they may have received from third parties.

D. EFFECT OF CONCORDATA ON FOREIGN-CURRENCY DENOMINATED DEBT

As of the date of the granting of a concordata decree, all foreign-currency denominated debt of the debtor company is converted into reais. Under current Brazilian law, this converted amount is not subject to monetary correction, although various court decisions have applied monetary correction to converted amounts in some fashion. The lack of any legal provision for monetary correction and the inconsistent application of monetary correction to converted amounts can result in a significantly diminished recovery of a company's foreign-currency denominated obligations.

E. THE RELIEF SCHEDULE

If the concordata is granted by the bankruptcy court, the terms of a company's repayment of its obligations are governed by an official relief schedule setting forth the amount due to each individual creditor. The company may choose to repay a certain percentage of the total amount due immediately and extinguish or delay repayment of the remainder. The percentage of debt that must be repaid is proportional to the length of time during which payment is extended. For example, a company may choose to repay 50% of the debt immediately and extinguish the remainder. If payment is postponed for six, twelve, eighteen or twenty-four months, however, the company must repay a minimum of 60%, 75%, 90% or 100% of the total debt, respectively. If any part of the repayment is to be made more than one year subsequent to the date of concordata, then the company must repay at least 40% of the total debt within the first year.

F. EFFECT OF CONCORDATA ON BUSINESS OPERATIONS

During the effective period of a concordata, a Brazilian company may continue to conduct its business and manage its affairs under the supervision of the Comissário and the bankruptcy court. The company may not, however, dispose of real property or pledge assets as collateral, except in cases of obvious necessity or vital interest to the company. Any such transactions must be approved in advance by the bankruptcy judge upon a petition made by the Comissário.

Since a company operating under concordata does not lose control of its business management, bilateral agreements to which such a company is a party will remain effective and must be fulfilled by all

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8 Articles 186 to 190 of the Bankruptcy Law provide a list of acts or omissions deemed to constitute bankruptcy crimes, such as the non-existence of company books, simulation of capital by the company to obtain credit, pre-payment of some creditors, and the presentation of false declarations regarding the situation of the company, among others.

9 Such an official protest requires a creditor to present evidence of the debt to an officer of the state judiciary for presentation to the company for payment. If the company fails to repay the debt, the officer will publish a record of such non-payment in the Official Gazette. The existence of a protested debt would strictly preclude a debtor from initiating preventive concordata proceedings, but such a requirement may be, and often is, waived by courts.

10 Bankruptcy Law, Article 156.
parties. All purchases made by the company after the filing of its concordata, however, must be made in cash.

G. CONVERSION OF CONCORDATA INTO FALÊNCIA

A concordata proceeding may be converted into a falência proceeding if, during or after the concordata proceedings, the debtor company fails to comply with its legal obligations under the court’s concordata decree. This conversion into falência may be declared by a judge under his or her own discretion or upon request by a creditor. Falência proceedings, and suspensive concordata proceedings, which may be proposed during the course falência, are discussed in further detail below.

II. FALÊNCIA PROCEEDINGS

Brazilian falência proceedings are conventional bankruptcy proceedings analogous to bankruptcy proceedings conducted in accordance with Chapter 7 of the U.S. Bankruptcy Code. The objective of falência proceedings is the liquidation of a debtor company's business and the distribution of its assets in satisfaction of the claims of creditors in accordance with a schedule of priorities, through a court-supervised process.

A. INITIATION OF FALÊNCIA PROCEEDINGS

Technically, a debtor company which, without reason, fails to pay a liquid debt is obligated to petition for bankruptcy. In practice, however, falência proceedings are normally initiated by one or more of the company's unsecured creditors. An unsecured creditor's application must be based on either the failure, without reason, of a company to pay a matured liquid obligation (supported by a prior protest for non-payment with an officer of the state judiciary) or the failure of the company to comply with its obligations under concordata proceedings. The petition for bankruptcy must include a statement of the reasons for default by the company supported by the applicable documentation, including, but not limited to, a current balance sheet and a list of the company's creditors with their respective credits.

A declaration of falência by a Brazilian company must be published in the Official Gazette and in a widely-circulated local newspaper in order to provide potential claimants with notice of the falência filing. Potential claimants then have twenty days to file their claims, which are subject to objection by the company, other creditors and the Síndico, a court-appointed trustee.

B. THE ROLE OF THE SÍNDICO IN FALÊNCIA PROCEEDINGS

In summary, the Síndico is a trustee, appointed by the court conducting the bankruptcy proceedings, to administer the bankruptcy estate. The responsibilities of the Síndico include: (1) hiring an accountant to examine the company's financial situation and prepare a corresponding report; (2) collecting all assets belonging to the company; (3) collecting any debts owed to the bankruptcy estate; (4) representing the bankruptcy estate as a plaintiff or defendant in any legal proceedings; (5) taking any steps necessary to protect the rights of the company's creditors; (6) upon obtaining a court's approval, disposing of the company's assets, normally through public auctions; and (7) paying the debts of the estate in accordance with the distribution schedule, as discussed more fully below.

C. IMMEDIATE EFFECTS OF A DECLARATION OF FALÊNCIA

A declaration falência by a court produces two immediate effects: (1) the company is divested from the possession of its business; and (2) all obligations of the company are accelerated (without the incurrence of contractual penalties arising from such acceleration). Interest on the company's indebtedness is not

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11 A debt is considered to be a liquid obligation when the amount due is not in dispute and is supported by clear and convincing evidence.
12 Bankruptcy Law, Articles 7 and 8.
13 The Bankruptcy Law determines that the Síndico must be appointed by the bankruptcy court from among the creditors of the debtor company. If the creditors of the debtor company refuse to accept the appointment, the bankruptcy court may appoint a third party, preferably a comerciante (businessman). Bankruptcy Law, Article 60.
14 A final declaration of falência serves to establish the date in which the bankruptcy began. The date selected may not be more than sixty days prior to the date that any outstanding debt was first protested. Bankruptcy Law, Article 14, item 111.
accelerated and is payable only to the extent the bankruptcy estate is sufficient to satisfy all of the company's principal obligations.

Importantly, Brazilian bankruptcy law does not authorize a bankrupt company's creditors to take over the operation of the company, even where such a take-over is likely to minimize the loss to the company's creditors. Although a creditor take-over is possible outside of bankruptcy proceedings, such a take-over would, under Brazilian law, require the company's approval and the payment of compensation to the company, a condition which most creditors find unacceptable.

D. EFFECTS OF FALÈNCIA ON FOREIGN-CURRENCY DENOMINATED DEBT

As with concordata proceedings, all foreign-currency denominated debt of the debtor company is converted into reais, without monetary correction, upon a declaration falência. The lack of any legal provision for monetary correction and the inconsistent application of monetary correction to converted amounts can result in a significantly diminished recovery of a company's foreign-currency denominated obligations. As a result, many foreign creditors are reluctant to force a Brazilian company into falência.

E. THE DISTRIBUTION SCHEDULE

As with United States bankruptcy laws, the distribution of the bankruptcy estate under the Brazilian legal system is governed by a statutory schedule of priorities set forth in the Bankruptcy Law. The schedule of priorities determines the following classes of claims, each of which must be satisfied in full before the following class of claims receives any compensation:

1. claims for compensation for workplace injuries;\(^ {15} \)
2. claims for wages and severance pay;\(^ {16} \)
3. claims for overdue federal, state and local taxes;\(^ {17} \)
4. claims relating to social security and other mandatory government programs;\(^ {18} \)
5. claims in connection with the debts and expenses of the bankruptcy estate;\(^ {19} \)
6. various classes of secured credits;\(^ {20} \) and
7. unsecured credits.\(^ {21} \)

F. CONVERSION OF FALÈNCIA INTO CONCORDATA

A falência proceeding can be suspended or terminated by the debtor company's initiation of a suspensive concordata. If granted by the bankruptcy court, a suspensive concordata would permit a debtor company to regain control of its assets and operations. To be eligible for a suspensive concordata, a company must: (1) convince the court in which the bankruptcy proceedings are being conducted that continuing the company's business is more beneficial to the estate than ceasing operations and liquidating the company; and (2) offer to pay its unsecured creditors at least 35% of the total debt if payment is to be made immediately or 50% of the total debt if payment is to be made in installments not to exceed a period of two years. In addition, if part of the payment is to be made over a period exceeding one year, at least 40% of the total debt must be paid within one year.

Once granted, a suspensive concordata binds all of the company's unsecured creditors, unless these

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\(^ {15} \) Bankruptcy Law, Article 102, Paragraph 1.
\(^ {16} \) National Taxation Code, Article 186.
\(^ {17} \) National Taxation Code, Articles 186 and 187.
\(^ {18} \) National Taxation Code, Article 187; Law No. 6830, of Sept. 20, 1980, and Decree-law No. 858, of Sept. 11, 1969, Article 2.
\(^ {19} \) Bankruptcy Law, Article 124.
\(^ {20} \) Bankruptcy Law, Article 124.
\(^ {21} \) Bankruptcy Law, Article 124.
creditors can demonstrate that they would face more losses under a suspensive *concordata* than under a pro rata distribution of the company's assets under *falência*. In addition, a suspensive *concordata* may be lifted if the debtor company subsequently defaults on the terms and conditions of the *concordata* decree.

Secured creditors are not affected by a suspensive *concordata* proceeding and remain free to foreclose on their collateral or otherwise pursue their claims against the company.
There is a proposal to amend the Bankruptcy Law (Decree-law 7661/45) now underway in Congress. In the early 1990s, there was a bill supported by representatives of the industrial and financial sectors. It was forwarded to the Ministry of Justice, which after a few amendments sent it on to Congress, initially as Bill 4376/93.

The central innovative feature of Bill 4376/93 was the concept of corporate recovery, alongside the concepts of *concordata* and bankruptcy. The bill was based on the presumption that a company, as an economic entity disconnected from the persons of its officers and controlling bodies, should be preserved, except when this is economically unfeasible. The legal form of the company is merely an organizational aspect, and has no repercussions as to the continuity of the company as an organized economic activity.

This characteristic is an exponent of the modern corporate theory, pursuant to which the importance that these companies generating production, taxes and jobs assume in the economy and society at large, would entail the consideration of the existence of a higher interest, all of its own, in relation to the interest of the shareholders and creditors, justifying the intervention of the government in the form of the judiciary branch and the creditors themselves, in the management of the company throughout the entire recovery process.

To this effect, the very Brazilian Federal Constitution establishes in its article 170, item III, the social function of property as one of the cornerstones of the Brazilian economic policy. The social function of property of the company or the social function of production means was the element that inspired the concept of corporate recovery and that would justify the intervention of the government and even of the creditors in the management of a company undergoing difficulties.

Corporate recovery would require the drafting of a plan, which would be submitted for approval of a creditors’ committee and for court ratification, and which would have repercussions for both employees and creditors. The partners of a company being reorganized would also be affected by the committee decisions.

During the recovery process, the company would be managed by trained professionals of impeccable reputation and acknowledged technical competence. Once the company had been both recuperated and reorganized, it could then return to its early administrators, except if the latter had acted fraudulently in the management of the company’s business, in which case the corporate interests could be alienated in court so as to give release for the company’s debts.

Recovery could as well entail a division of the economic unit, in the form of spin-off or merger, with transfer of the shareholding control of the company being recuperated, whether or not associated with other types of company reorganization, and this could as well constitute another instrument to shore up the company in crisis.

With regard to payment of creditors, those directly linked to the operating activities, such as those resulting from labor and accident law, as well as purveyors’ credits, especially those that are still actively supplying the company, will be given preference. Despite all this, the recovery process would continue to be subject to jurisdictional protection.

The initial bill however encountered strong resistance in Congress, as there is an accentuated tendency in Brazil to protect debtors.

Another point that generated congressional opposition to the institution of recovery was the provision contained in the initial bill, to the effect that the assets of the company in point, as well as its shareholding control, could be both alienated and transferred with a view to payment of the creditors (a possibility which currently exists only at the end of the bankruptcy process, in the assets liquidation phase).
This was considered unconstitutional, insofar as the Federal Constitution has as its cornerstone the total protection of private property (which can only be judicially withdrawn from the owner via due process of law), for which reason the assets of the impresario whose company is subject to recovery, in the opinion of Congress, should continue under such management.

In light of this, Bill 4.376/93, as initially conceived, has been gradually altered, through four alternative drafts submitted to House of Representatives, which in the end completely eliminated its original and innovative aspects.

In general, the modifications presented target a change in the overall project structure, so as to ensure autonomy and independence between the recovery and the judicial liquidation. Thus, the bankruptcy will come to be called judicial liquidation, and the concordata will be known as recovery, and the concept of corporate recovery as something distinct from the concepts of concordata and bankruptcy was in the end mingled with the different types of concordata (preventive and suspensive), and lost its initial characteristics.

In addition, the following points should be taken into consideration:

- There is also a possibility of instating the recovery process before or after the judicial liquidation is decreed, which would respectively be equated with the preventive and suspensive concordatas, whenever it can be evidenced that the debtor has overcome the facts and circumstances leading to the liquidation;
- There was an increase in the list of matters that could be subject to recovery or judicial liquidation, via inclusion of the civil companies and the individuals that carry out economic activities;
- The management of the company undergoing recovery will be monitored by a court administrator and by a committee comprising representatives of the creditors and employees, all appointed by the judge decreeing the recovery;
- Additionally, once recovery has been decreed, organization of the company comprising assets of the company undergoing recovery and its creditors can be authorized;
- Recovery can be carried out in no more than 5 (five) years;
- Recovery does not stand in the way of the company owner’s managing the assets, and is quite similar in this respect to concordata as we know it;
- Judicial liquidation can be petitioned for by company employees, by a decision approved by 2/3 of such employees, when wage payment has been in abeyance for more than 60 (sixty) days;
- The company in liquidation will then be administered by the court administrator and monitored by the committee mentioned above;
- Any decision terminating the obligations of the debtor in the judicial liquidation will also set out the termination of the sureties’ liability; and
- A finding of bankruptcy crimes will entail the debtor’s being disqualified for 10 (ten) years from engaging in economic activities, or contributing thereto, and in a permanent inability to participate of the board of directors or executive board, to be a manager or attorney in fact for any company pursuant to said law.

Please note that the alternatives mentioned in Bill 4376/93 did not even take into consideration the possibility of including the provisions allowing for disregard of legal entity undergoing recovery or liquidation, so as to allow for rapid recovery of assets that can be shown to be part of the company assets and were transferred fraudulently to another company belonging to the bankrupt.

Finally, please note that the alternatives to Bill 4.376/93, along general lines, both adopt a clearly protectionist stance with regard to debtors, to the detriment of creditors. Furthermore, currently the alternatives are in their fourth version, and there are no perspectives at all as to when this bill (in the form of alternative four or otherwise) might be approved, given that it has been in Congress since the early 1990s.
Besides this, there has been some discussion involving lawyers and representatives of the industrial and financial sectors about how to propose some new project that would only concern the recovery of the company. This new project would not change or affect Decree-law 7661/45, which would continue to regulate bankruptcy and concordata proceedings in Brazil. Despite all this, to date this idea has not been transformed into a bill to be sent to the Brazilian National Congress.
APPENDIX VI

PRINCIPAL DIFFERENCES BETWEEN ACCOUNTING PRINCIPLES
IN BRAZIL AND THE UNITED STATES OF AMERICA
AND INTERNATIONAL ACCOUNTING STANDARDS

A. ACCOUNTING CHANGES

Under Brazilian GAAP, the cumulative effect of changes in accounting principles are generally applied as an adjustment to the current year’s beginning equity or prior year financial statements may be restated. Under U.S. GAAP, except for certain specified changes, the cumulative effect of changes in accounting are disclosed separately as an adjustment to earnings in the year of the change, along with pro forma disclosures of the effects on prior years. Under IAS, changes in accounting policy, if necessary, should be made retrospectively resulting in prior period financial statements and the opening retained earnings being adjusted and the nature and effects of the adjustment on the current and prior periods disclosed. An alternative, under IAS, is to present such adjustments prospectively with appropriate footnote disclosure of the effects on the current and prior periods.

Changes in estimates may be accounted for as changes in accounting principles under Brazilian GAAP. Under U.S. GAAP and IAS, the effects of changes in accounting estimates are reflected in the current and prospective periods.

Accounting errors, in Brazil, are generally applied as an adjustment to the current year’s beginning equity or prior year financial statements may be restated. Generally, under U.S. GAAP and IAS, errors in accounting should be corrected by adjusting current and prior period’s financial statements and opening retained earnings with appropriate footnote disclosure of the effects of the error on the current and prior periods. An alternative under IAS is to present the effects of such errors currently with appropriate footnote disclosure of the effects on the current and prior periods.

B. MARKETABLE DEBT AND EQUITY SECURITIES

Under Brazilian GAAP, marketable debt and equity securities are generally stated at the lower of cost, monetarily corrected, or market value, with losses recognized in the results of operations. Certain specialized industries account for such securities at market with gains and losses recognized in the results of operations. Additionally, certain specific investments (mutual fund investments) may be carried at market.

Under U.S. GAAP, for enterprises in industries not having specialized accounting practices, marketable equity securities may be carried at: (a) amortized cost (debt securities held to maturity); (b) market, with gains and losses reflected in income (debt and equity securities classified as trading); and (c) market with gains and losses reflected in equity (debt and equity securities classified as available for sale).

Under IAS, marketable securities may be accounted for at market value, cost, or the lower of cost or market and classified as current or long-term assets with gains and losses recognized in the results of operations.

C. DEFERRAL OF PRE-OPERATING EXPENSES

Under Brazilian GAAP, pre-operating expenses incurred with the construction or expansion of a new facility may be deferred until the facility begins commercial operations. Substantially all costs related to the organization and start-up of a new business may be capitalized. The amount, as adjusted for inflation by the monetary correction system, may be amortized over a period of five to ten years.

In general, U.S. GAAP and IAS are more restrictive as to the costs that may be capitalized and the periods over which such costs are amortized. Construction and expansion costs are generally allocated to property, plant and equipment; pre-operating and start-up expenses are normally charged to operations; and organization costs of a new business are deferred. In certain, specialized situations specific pre-operating and
start-up expenses may be deferred and amortized.

D. INVENTORIES

Inventories are valued at the lower of unindexed cost or market under the Corporation Law method. Under the constant currency method, such costs are reflected at purchase cost (excluding interest) indexed by inflation rates to the year-end. Such valuation may not exceed market. Under Brazilian GAAP, the actual cost of production can be determined by the first-in, first-out (FIFO) or average cost methods.

Under U.S. GAAP, inventories are stated at the lower of cost or market. In the U.S., the actual cost of production can be determined by the first-in, first-out (FIFO), the last-in, first-out (LIFO) or average cost methods.

Under IAS, inventories are stated at the lower of cost or net realizable value. The actual cost of production can be determined by the first-in, first-out (FIFO), the last-in, first-out (LIFO) or average cost methods.

E. PROPERTY, PLAN AND EQUIPMENT

Under Brazilian GAAP, property, plant and equipment is presented at monetarily corrected adjusted cost less accumulated depreciation. Depreciation is determined and calculated based upon the estimated useful life of the asset. Valuation at appraisal value (based on the report of an independent appraiser) is also permitted. The difference between appraisal value and monetarily corrected adjusted cost is included as technical revaluation reserve in shareholders’ equity. Amortization of the appraisal increment is charged to operations and an offsetting portion of the technical revaluation reserve is transferred to retained earnings.

Under U.S. GAAP, property, plant and equipment is carried at cost less accumulated depreciation. Depreciation is determined and calculated based upon the estimated useful life of the asset. Financial Accounting Standards Board Statement (FAS) No. 121—Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of—requires that the measurement of any impairment loss for such assets and identifiable intangibles be based upon the fair market value of the assets.

Under IAS, property, plant and equipment may be presented at cost less accumulated depreciation subject to the requirement to writedown an asset to its recoverable amount. Depreciation should be allocated based upon a systematic basis over the estimated useful life of the asset. Revaluation of property, plant and equipment at its fair value (based on the report of an independent appraiser) less any subsequent accumulated depreciation is also permitted. The increase due to revaluation is included as a revaluation surplus in shareholders’ equity.

F. CAPITALIZATION OF FINANCING COSTS

Under Brazilian GAAP, interest costs incurred as part of the acquisition or production cost of fixed asset items are not capitalized to property, plant and equipment. Instead, financial costs net of financial income, related to property additions are often capitalized as deferred charges and amortized over a period varying from five to ten years. In Brazil, recent DNAEE rules require net financial costs to be capitalized to property, plant and equipment instead of treated as a deferred charge.

Under U.S. GAAP and IAS, interest costs incurred during the construction or acquisition period of qualified assets is capitalized as part of the cost of such assets and depreciated over the respective life of the asset.

G. DISCOUNTING

In Brazil, under the integral correction method of accounting, the interest element included in current and non-current receivables and payables is charged or credited to operations. Under the Corporation Law method, discounting also is permitted but not required. Under U.S. GAAP, only the effect of discounting certain long-term receivables and payables is accounted for in the results of operations. Under IAS, the
discounting of revenue and receivables to the fair value of consideration received is permitted.

H. LEASES

Under Brazilian GAAP, generally, lessees account for long-term leases as operating leases, whereas in accordance with U.S. GAAP and IAS such leases could be accounted for as operating or capital leases. As a result, in Brazil, lease payments by lessees with respect to leases are charged to expense as incurred. Under U.S. GAAP and IAS, the lease payments may be charged to expense as incurred (operating lease) or the leased asset and the corresponding lease liability may be recognized in the balance sheet and the effects of depreciation and interest expense in the results of operations (capital lease). For capital leases, the portion for the subsequent lease payments determined to be principal are recorded as a reduction of the recorded lease liability.

In Brazil, lessors account for their leasing operations in accordance with specified regulations which are not in accordance with Brazilian GAAP and adjust financial position and the results of operations to reflect Brazilian GAAP by recording the present value of each lease contract. Under U.S. GAAP and IAS, lessors account for each lease contract as either operating, financing or sales-type leases depending on the terms of the lease contract. Also, U.S. GAAP and IAS rules for lease accounting require significantly more disclosure than is provided in Brazil.

I. TAXATION

In Brazil, deferred income taxes are recognized for differences between book and tax accounting (the deferral method). In Brazil, a net deferred tax asset is recorded only if it is assured beyond a reasonable doubt that the assets will be recovered by taxes payable on future profits.

Under U.S. GAAP, deferred taxes are recognized by the liability method for temporary differences and significant tax disclosures are required. Deferred tax benefits are recognized when it is more likely than not that a tax benefit will be realized.

Under IAS, either the deferral or liability method may be utilized. A deferred tax asset is recorded only if it is reasonable to expect that the assets will be realized in the future. The benefits of net operating loss carryforwards are recognized if realization is assured beyond a reasonable doubt.

J. FINANCIAL INSTRUMENTS AND DERIVATIVES

Under Brazilian GAAP, financial instruments and derivatives may be accounted for at cost, contract value or market with footnote disclosure of the type and amounts of financial instruments and derivatives.


IAS does not specifically address such accounting matters.

K. CONTINGENCIES

In Brazil, the accounting and disclosures of contingent liabilities are generally not as comprehensive as is required in U.S. and IAS.

L. RESEARCH AND DEVELOPMENT

The costs of research and development projects may be capitalized under Brazilian GAAP when such amounts are determined to be recoverable. Under U.S. GAAP and IAS, these costs are generally charged to expense. However, IAS permits the capitalization of development costs for specific products and processes.
M. PENSIONS

In Brazil, for those companies with formalized pension plans, pension contributions are actuarially determined and expensed as the contributions are made. Disclosure of pension plan assets and liabilities is generally not provided.

In the U.S., pension expense is determined in accordance with FAS 87—“Employers Accounting for Pensions” based upon the actuarially determined Projected Benefit Obligation (PBO) and is accounted for on the accrual basis. Disclosure of pension plan assets and liabilities and expense is extensive and detailed.

Under IAS, pension expense is determined actuarially using either an accrued benefit or a projected benefit method of valuation. Disclosure of pension plan assets and liabilities is required.

N. STATEMENT OF CASH FLOWS

In Brazil, the excess of current assets over current liabilities analyzes the source and application of funds (working capital) in a statement of changes in financial position, except for banks and other financial institutions, for which the Central Bank requires the presentation of a statement of changes in cash position.

U.S. GAAP and IAS require that a statement of cash flows be presented identifying cash flows from operating, investing and financing activities utilizing either the direct or indirect method of presentation.

O. EXTRAORDINARY ITEMS

The disclosure of extraordinary items is limited to certain specific items (e.g., gains and losses on debt extinguishment) under U.S. GAAP. Under IAS, the nature and amount of extraordinary items should be separately disclosed. In Brazil, there had been no similar accounting or disclosure standard; however, recently the Brazilian Securities Commission (CVM) has permitted companies to disclose unusual and infrequently occurring adjustments as an extraordinary item in the results of operations.

P. EARNINGS PER SHARE (EPS)

In Brazil, disclosure of earnings per share is required for all corporations regardless of whether their shares are publicly traded. The calculation of EPS is based upon the number of shares outstanding at the end of the year. Under GAAP, only public companies are required to present such information and the calculation is based upon the weighted average common shares and common share equivalents outstanding during the year. Also, U.S. companies are required to present both primary and fully diluted EPS, where appropriate.

Q. OTHER DISCLOSURES

Brazilian financial statements do not have the same level of disclosures as required by U.S. GAAP and IAS in their disclosure of the following:
- general business, political and economic risks,
- major customers and sales by geographic area,
- related party transactions,
- pension plans,
- income taxes,
- concentration of credit risks, and
- leases.

Brazilian financial statements have a more detailed level of disclosure than that required under U.S. and IAS accounting principles for investments in subsidiaries and affiliates.