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HIGHLIGHTS

Governments and Business React to Global Financial Crisis

Chile announces an economic stimulus package. *Page 24* *LALBR* looks at steps the Mexican government has undertaken to assist Mexican companies. Options for workouts and bankruptcy procedures are also considered. *Page 28* Strategies for corporate debt restructuring in Argentina are reviewed. *Page 11*

What is Ahead for Latin American M&A in the Face of the Economic Crisis

While the global financial crisis has changed the ways to accomplish Latin American M&A, opportunities still abound, according to the new head of Latin America M&A at Barclay's Capital. *Page 3* However, in Latin America, all signs point to a sharp slowdown in 2009. *Page 4* A look at top announced deals in 2008. *Page 7*

Investing in Brazil During the Financial Crisis

Brazil remains an attractive investment target despite the current international financial meltdown. Brazilian banks operate under a set of strict regulations that have had an inhibitory effect against risky financial practices, though financing for M&A is still hard to find. *Page 13* LBO's may no longer be an option in Brazil. *Page 17*

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Interview with New Barclay's Head of Latin American M&A

By Dan Weil

While the global financial meltdown and recession have put a dent in Latin America's merger and acquisitions market, opportunities still abound there, says Udi Margulies, the new head of Latin America M&A at Barclays Capital.

"The crisis has produced several impacts," he told VELA in a recent interview. "First, credit for large cash transactions isn't as available as it used to be," he says.

"To do $1 billion-plus, cross-border transactions like those that took place in 2007-08 requires access to bank financing and capital markets in U.S. dollars. That's dried up, except for a few of the highest- rated corporate credits in the region."

For companies like Wal-Mart, which Barclays recently advised in its $3.6 billion offer for Chile's largest grocery chain D&S, it's a different story.

What deals are available? "Local equity and debt markets in Mexico, Chile and Brazil are starting to thaw," Margulies says. "There are going to be more stock-for-stock deals, locally financed deals as well as deals financed by the seller, as in the recent Votorantim acquisition of Aracruz, rather than cash transactions."

Another major development has been the crash of the commodities market – everything from copper to steel to oil to agricultural produce. "That has had a significant impact on a lot of corporations in the region," Margulies says.

Companies like Vale do Rio Doce, Petrobras, food companies, even construction-related companies like Cemex, have been affected. In some sense that creates an M&A opportunity.

The strong companies will be buyers, and the weak may be forced to sell assets or themselves. "Companies with strong balance sheets, like Vale, which raised a $14 billion war chest in an IPO before the market collapsed, will be in a strong position," Margulies says. "Those laden with debt won't be."

The currency crises that followed the collapse of Lehman Brothers, Merrill Lynch and AIG in September also were important. "There was a significant flight to quality from equity and debt investors in emerging markets to U.S. Treasuries, forcing large devaluations in Latin currencies," Margulies points out.

The currency crises caused significant losses for companies that were hedging their currency exposure by going short dollars and long local currencies. The devaluations caused huge losses for companies like Comercial Mexicana, Vitro and Cemex in Mexico and Aracruz and Sadia in Brazil.

Daniel Weil is a reporter for Venture Equity Latin America, also published by WorldTrade Executive, Inc.

These companies have suffered losses on their derivatives positions, which means they could generate M&A opportunities either from divesting assets or from capital infusions into the companies by strategic investors.

The currency drops also could spark M&A activity in another way. "They make the region more attractive for U.S. and European multinational corporations (MNCs)," Margulies says. "The region is still growing. Several local companies are world class and have strong positions in their markets. Now their valuations are more reasonable."

The currency drops also could make the region more attractive for U.S. and European multinational corporations (MNCs).

In each industry, there are companies that are "constrained" and "unconstrained," Margulies says. The unconstrained, healthy companies will be able to take advantage of strategic opportunities amid the restructurings that the weaker, constrained companies will have to undergo.

Latin America's M&A market created $136 billion of announced deals in 2008, with Barclays advising on $20.5 billion of the action, or 15 percent. That made the British bank the No. 8 player in the market.

Barclays' biggest coups included the Wal-Mart acquisition, Telmex' $16 billion spinoff of Telmex Internacional and Aceros San Luis' $850 million sale to Grupo Simec, creating one of Mexico's biggest steelmakers.

Among the most appealing industries to Barclays are telecommunications, the consumer sector, mining and metals and financial institutions. "These are industries that are very global," Margulies notes. "There is a lot of cross-border and local activity in them that plays to the core strength of our franchise in M&A and industry capabilities."

The power sector in Brazil could see some M&A action, he says. "Utilities are in a consolidation mode there. Some foreigners are looking to redeploy investments in their home markets, while the local utilities are in good financial condition to effect transactions."

As for countries, the main two are Brazil and Mexico, Margulies says, noting that Brazil has seen more than 50 percent of Latin America's M&A volume over the last two-three years, both cross-border and intra-country deals. Colombia and Chile also represent vibrant M&A markets. Under Alvaro

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Uribe, Colombia has significantly improved its security and political stability. "That has helped the economy grow – both the consumer sector and foreign investment," Margulies says. "The regulatory framework has become stable. The country risk has decreased significantly. It is on the verge of being lifted to investment grade, making it more attractive to MNCs."

Colombia's 45-million population and close trade ties with the U.S. also make it attractive to foreign companies. "We are starting to see more investment inflows," he says. "We haven't yet seen the development of Colombian MNCs like in Brazil and Mexico. Hopefully that's the next step."

As for Chile, "despite a small economy, it's always been the most stable country in the region," Margulies points out.

"It has deep local markets, with significant assets under management for pension funds. It has a low cost of capital and a large middle class, which foments the local market. Some of its companies have ventured abroad, creating MNCs in the region."

For example, supermarket company Cencosud has bought chains in Argentina, Peru and Brazil, generating cross-border flows. Margulies is bullish on Latin American M&A compared to some other geographic areas. "My view is that the region will suffer less than the U.S. and Europe," he says. "With the exception of Mexico, which is highly dependent on trade and remittance inflows from the U.S., the rest of Latin America will feel the impact of the global crisis via two other transmission mechanisms: commodity prices/exports and external financing."

"M&A activity will slow down," Margulies says. "But we still will see a lot of deals done. Deals requiring significant financing and cash will be more challenging, but others will get done."

Domestic economies will continue to grow, though probably at 2-3 percent annually, compared to 5-6 percent in the last few years, he says. "The banking system in the major countries is not in shambles like in the U.S. and U.K. It needs no intervention from the government. Currency devaluations will help exports."

Bottom line: "M&A activity will slow down," Margulies says. "But we still will see a lot of deals done. Deals requiring significant financing and cash will be more challenging, but others will get done." ❑

For Latin America, All Signs Point To A Sharp Slowdown In 2009

By Lisa M. Schineller (Standard & Poor's)

Latin America will not be spared from the global economic slowdown in 2009. Deep recession in the industrialized countries, distress in the capital markets (both global and local), and the fall in commodity prices are set to depress growth across the region. Once-robust domestic demand won't be able to withstand these pressures, and slower growth in emerging Asia will further reduce external demand for the region. Standard & Poor's Ratings Services projects that, in 2009, weighted average real GDP growth in Latin America will be less than half of what it was this year, dropping to 2.1% from 4.8%.

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Efforts To Curb The Economic Shock

Some countries (including Argentina, Brazil, Chile, Mexico, and Peru) have announced fiscal packages to mitigate the economic slowdown, but we don't expect them to be able to meaningfully offset the heavy drag on growth from the deteriorating global backdrop. In general, Latin American governments aren't able to pursue aggressive countercyclical fiscal policy in order to combat economic downturns. Comparatively high levels of debt and shorter track records of economic stability compared with some other emerging markets leave less room for policy maneuvering. We do expect fiscal balances to deteriorate, in some countries more strongly than in others, because of lower growth, the decline in commodity revenue, and increased borrowing costs.

Since the extreme global credit market dislocation began in September 2008, central banks and governments stepped in to stabilize local markets by boosting domestic liquidity and smoothing the fast pace of exchange rate depreciation. Central banks shifted quickly from a monetary-policy tightening mode to a wait-and-see stance amid the global uncertainty. In 2009, we expect a number of central banks to cut their policy rates as inflation is projected to decline along with the sharp slowing in economic activity. However, despite the projected easing in policy rates, increased risk aversion and tighter lending standards are likely to limit both the availability of credit and the drop in borrowing costs. The changed global economic conditions--namely, tight global liquidity and commodity prices down more than 50% since they peaked in mid-2008--imply that Latin American currencies will remain much weaker than they were in the first half of 2008. Exchange rate intervention by central banks can smooth, but not alter, this trend.

Latin Countries Have Stronger External Positions

Nevertheless, Latin American countries are in better shape than they have been in decades to manage the extremely challenging global environment and withstand the expected decline in trade surpluses and pressure on current account deficits. Average gross external debt as a share of exports of goods and services for the region is half of what it was in 2002, when Latin America experienced its last crisis. Net debt is almost one-tenth of its 2002 level. Most measures of external financing needs and debt service are about half the size they were in 2002 as well. Furthermore, exchange rate regimes are now more flexible. This situation stands in marked contrast with Latin America's past legacy of extreme external vulnerability. However, in the context of tight global liquidity and ongoing adjustment in asset allocation, securing any amount of financing will be difficult.

Most Latin American sovereigns are better positioned than their private sectors to manage external financing needs. Lower foreign direct investment and portfolio inflows (possibly outright outflows) will put a strain on capital accounts, and the region-wide buildup in international reserves is set to reverse course. Governments have stepped in to assist the banking and corporate sectors as foreign banks cut international trade and interbank lines and local markets became illiquid even for the rollover of outstanding debt. Reversing the recent trend of paying down multilateral borrowing, governments across the region have begun to line up financing from official international financial institutions--both for themselves and for the private sector.

Expecting A Sharp Slowdown In Growth

Since September, we have sequentially lowered the outlook for growth across the region. We now forecast weighted average real GDP of about 2.1%. This outlook incorporates strong economic deceleration in Brazil and outright contraction in Mexico, which together account for two-thirds of the region's GDP.

Brazil showed no sign of weakness through the third quarter of 2008. Real GDP actually surprised us with an expansion of 6.8% over the same period in 2007, led by a 19.7% increase in investment. However, a sharp deceleration in economic activity began in the fourth quarter because of the tightening in local capital markets associated with the distress in global capital markets. We're projecting Brazil's real GDP growth at 2.5% for 2009, from an estimated 5.7% in 2008. We expect domestic demand, investment in particular, to slow dramatically as local and international capital and credit are scarce and costly and businesses curtail their expansion plans. Signs of already weaker labor market conditions will contribute to a reduced pace of consumption as well.

Latin American countries are in better shape than they have been in decades to manage the extremely challenging global environment and withstand the expected decline in trade surpluses and pressure on current account deficits.

In Mexico, we expect an outright economic contraction, with real GDP of negative 0.5% in 2009. External demand will likely take a hard hit given the tight correlation between U.S. and Mexican industrial sectors, the concentration (80% to 85%) of Mexico's exports to the U.S. (where Standard & Poor's projects real GDP to post a decline of 1.2% in 2009), the recession in Europe (a region that has accounted for much of the diversification of exports away from the U.S.), and lower tourism. Furthermore, consumption is likely to suffer from the drop in remittances from Mexican workers in the U.S. and tighter local credit conditions.

Elsewhere in the region, we see Argentina growing at 2.5%, Chile at 2%, Colombia at 3%, and Venezuela at 3.3%. We expect Peru and Panama to post the strongest growth in the region, at 6% and 5.5%, respectively. Argentina and Venezuela are particularly vulnerable to commodity price declines, which exacerbate their already poor prospects for private investment given the distortionary economic policies in place. We expect the sharp slowdown in international trade to weigh heavily on Panama's rate of real GDP growth, while construction associated with the Panama Canal expansion project will otherwise support domestic investment. Domestic demand and real GDP already slowed sharply in Colombia during 2008, and the external drag in 2009 provides no relief. In both Chile and Peru, we expect 2008's breathtaking pace of investment of over 20% to slow sharply, and exports to suffer from the downturn in commodity demand.

Tighter Local Credit Markets

Just as their global counterparts have, credit markets across the region have come under varying degrees of stress since September. An important starting point for the region compared with other emerging markets is that Latin America has a lower level of financial-sector intermediation, or domestic credit to GDP. This implies, on balance, that governments

A Sharp Slowdown, Continued on page 6

A Sharp Slowdown (from page 5)

face a lower contingent liability from potential problems in their banking systems. In addition, we consider key banking systems across the region to be well capitalized, with little-to-no exposure to the securitized assets that have been problematic for other banks and banking systems globally. Capitalization ratios are above the respective national statutory minimums, with Brazil at 14.6%, Chile at 11.7%, Colombia at 12.5%, Mexico at 15.9%, and Peru at 8.4%. Argentina and Venezuela, which have the weakest banking systems in the region, have capital ratios of 17.1% and 9.2%, respectively. Loan-loss provisioning, as a share of nonperforming loans, is over 100% in all cases and over 200% in Peru.

Despite sound levels of capitalization, Latin American banking systems have not escaped the dislocation in the global credit markets. As a result, central banks across the region have stepped in to ease the tightening of local liquidity. Brazil's central bank, for example, has lowered reserve requirements (from very high levels) and broadened the set of assets eligible for repurchase ("repo") operations. Chile, Colombia, and Peru also eased reserve requirements that in some cases were raised earlier this year.

In addition, the Brazilian, Chilean, Mexican, and Peruvian central banks also shifted from a monetary-policy tightening mode to a wait-and-see stance given global uncertainty and deflation in commodity prices. This occurred even though inflation in all these countries remains above target, suffering from the lagging second-round effects of the earlier commodity price spikes and increased wage demands, as well as recent exchange rate depreciation. A sharp slowdown in growth and lower commodity prices are expected to lower inflation in 2009. This, in turn, will facilitate monetary policy easing in 2009. At its December meeting, the Colombian Central Bank initiated its easing cycle--the first central bank in the region to do so.

Despite concerted policy measures to free up liquidity and the prospect of interest rate cuts by central banks, we expect bank lending to slow dramatically in 2009, which will contribute to the deceleration in domestic demand. Even though domestic credit only averages 35% of GDP in Latin America, it has grown on average 24% per year from 2004 to 2008. The high rate of growth in credit, albeit from a low base, has supported both consumption and investment: Credit became available to lower-income groups and small and midsize businesses without prior access in Brazil, Mexico, and Peru. Governments concerned with a sharp slowdown in credit by private financial institutions are poised to increase lending through government-owned financial institutions. Brazil and Mexico, for example, have announced specific programs to supply credit to small and midsize enterprises through their development banks and support for the housing sector through other government-owned banks or entities. We expect government-owned banks and financial institutions to play a more active role in local credit markets over the coming year.

Stalled Local Capital Market Development

The dislocation in the global capital markets has set back some of the progress in the development of local capital markets in Latin America. We do not expect it to pick back up until the wealth destruction and deleveraging in the industrialized markets stabilize. Economic stability, low inflation, and government debt management practices to extend domestic yield curves helped deepen local markets and supported private-sector bond / debenture issuance. Still-incipient securitization products began to expand, especially in Brazil (with credit receivables funds known as FIDCs) and Mexico (with mortgage-backed securities). While local market issuance slowed over the course of 2008, the markets have been dealt a strong blow since September. Governments have had to move to the shorter end of their yield curves and provide assistance to the private sector. For example, the Mexican government stepped in with its development banks to partially guarantee the rollover of commercial paper, the tenor of which has shrunk dramatically.

The dislocation in the global capital markets has set back some of the progress in the development of local capital markets in Latin America.

Calls for more comprehensive regulation, supervision, and reporting have arisen in Latin America as they have in industrialized countries. Brazilian and Mexican firms' imprudent use of "toxic" foreign exchange derivatives has tainted the perception of improved corporate governance (besides exacerbating short-term exchange depreciation). The regulatory authorities in both countries have required increased disclosure of derivatives, but greater investor scrutiny and skepticism are likely to linger. Some corporations' improper risk-taking could raise borrowing costs for the sector as a whole.

Weaknesses in the counterparty over-the-counter trading model that dominates the global financial market architecture came to the fore in Latin America as officials in Brazil and Mexico sought to quantify the outstanding amount of toxic derivatives. While many of these transactions were indeed over-the-counter, Brazil's financial system uses independent clearinghouses for a significant share of its derivatives business. This helps limit the risk of counterparty confidence crises and complications from the bankruptcy of a key counterparty. There are also comprehensive registration requirements for financial contracts (including securitized products), which enable the authorities to more easily quantify exposure and risk in the system. Increased recourse toward such practices seems likely to follow in other capital markets.

The region's stock markets have taken just as hard a hit as other global stock markets. Lower local growth prospects, the marked drop in commodity prices (which particularly affects some of the largest companies on local exchanges), and significant withdrawals of foreign investment have all contributed. While stock markets in Latin America do not play nearly the same role in terms of absorbing broad-based household wealth and savings as they do in industrialized countries, there has been an impact on local pension funds, etc., and their sharp decline limits corporate funding prospects. The IPO boom in Brazil provided an important source of new affordable funding, especially for small and midsize firms, and facilitated higher corporate investment and increased formalization of the economy (given disclosure requirements). Just as this funding channel contributed to Brazil's positive growth momentum, its shutdown will contribute to Brazil's slowdown.

Latin America is facing the most challenging global backdrop in decades. Our projections imply that real GDP growth for the region will be its lowest since 2002. The recent period of robust global growth, high commodity prices, and abundant global liquidity facilitated a reduction in fiscal and external weaknesses, and placed the region in its best position ever to face the global economic slowdown and ongoing adjustment in global capital markets. Nevertheless, the local credit and capital markets won't be able to provide the support for growth and improved standards of living that they did during the past five years. This will further reinforce the drag on growth stemming from abroad. As a result, 2009 will test the resilience of the economic improvements that have occurred in the region. It will also test the policy commitment of Latin American governments just as the region begins a series of presidential elections spanning the next two years. ❑

Latin America: Top Announced Deals 2008

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Activity table for Latin American M&A Y/E 2008

Announced Date	Bidder Company	Bidder Financial Advisor	Bidder Legal Advisor	Target Company	Target/Seller Financial Advisor	Target/Seller Legal Advisor	Seller Company	Deal Value (US$m)
03-Nov-08	Itau Unibanco Banco Multiplo SA	Morgan Stanley	Shearman & Sterling	Uniao de Bancos Brasileiros SA	Rothschild	Barbosa, Muessnich & Aragao; Cleary Gottlieb Steen & Hamilton		17,757
25-Mar-08	Bovespa Holding SA	Banco Bradesco BBI; Credit Suisse; Goldman Sachs	Barbosa, Muessnich & Aragao; Shearman & Sterling; Skadden Arps Slate Meagher & Flom (Advising Goldman Sachs)	Bolsa de Mercadorias e Futuros	Citigroup; JPMorgan; Rothschild	Mattos Filho, Veiga Filho, Marrey Jr. e Quiroga Advogados; Weil Gotshal & Manges		7,320
31-Mar-08	Anglo American Participacoes em Mineracao Ltda	Goldman Sachs; UBS	Linklaters; Machado Meyer Sendacz e Opice; McCarthy Tetrault; Sullivan & Cromwell	IronX Mineracao SA	Credit Suisse	Davis Polk & Wardwell; Gibson Dunn & Crutcher; Mattos Filho, Veiga Filho, Marrey Jr. e Quiroga Advogados		5,519
25-Apr-08	Telemar Participacoes SA	Credit Suisse; Itau Unibanco Banco Multiplo; Morgan Stanley; Rothschild	White & Case	Brasil Telecom Participacoes SA (35.2% stake); and Brasil Telecom SA (18.08% stake)	Citigroup			4,679
19-Dec-08	Wal-Mart Stores Inc	Barclays Bank; IM Trust; UBS	Claro y Cia; Hogan & Hartson; Wachtell Lipton Rosen & Katz	Distribucion y Servicio SA	JPMorgan	Simpson Thacher & Bartlett		3,667
25-Apr-08	Telemar Participacoes SA	Credit Suisse; Itau Unibanco Banco Multiplo; Morgan Stanley; Rothschild	White & Case	Brasil Telecom Participacoes SA (22.28% stake)	Citigroup	Barbosa, Muessnich & Aragao; Mattos Filho, Veiga Filho, Marrey Jr. e Quiroga Advogados		3,535
21-Oct-08	Itochu Corporation; JFE Steel Corporation; Kobe Steel Ltd; Nippon Steel Corporation; Nisshin Steel Co Ltd; POSCO; and Sumitomo Metal Industries Ltd	JPMorgan	Cleary Gottlieb Steen & Hamilton	Nacional Minerios SA (40% stake)	Goldman Sachs		Companhia Siderurgica Nacional	3,120
31-May-08	Sterlite Industries India	ABN AMRO	Khaitan & Co; Shearman & Sterling	Asarco LLC	Lehman Brothers	Baker Botts; Milbank Tweed Hadley & McCloy	Grupo Mexico SAB de CV	2,600
10-Dec-08	Grupo Bimbo SA de CV	Atlas Strategic Advisors	Cleary Gottlieb Steen & Hamilton; Ritch Heather y Mueller; Stikeman Elliott; White & Case	Weston Foods Inc (US bakery business)	*Advising seller:* CIBC World Markets	*Advising seller:* Mayer Brown	Dunedin Holdings Sarl	2,500
09-Oct-08	Criteria Caixa Corp SA	KPMG; Lazard	Garrigues	Grupo Financiero Inbursa SA de CV (20% stake)				2,146

Latin America: Top Announced Inbound Deals 2008

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Activity table for inbound Latin American M&A Y/E 2008

Announced Date	Bidder Company	Bidder Financial Advisor	Bidder Legal Advisor	Target Company	Target/Seller Financial Advisor	Target/Seller Legal Advisor	Seller Company	Deal Value (US$m)
31-Mar-08	Anglo American Participacoes em Mineracao Ltda (subsidiary of Anglo American Plc)	Goldman Sachs; UBS	Linklaters; Machado Meyer Sendacz e Opice; McCarthy Tetrault; Sullivan & Cromwell	IronX Mineracao SA	Credit Suisse	Davis Polk & Wardwell; Gibson Dunn & Crutcher; Mattos Filho, Veiga Filho, Marrey Jr. e Quiroga Advogados		5,519
19-Dec-08	Wal-Mart Stores Inc	Barclays Bank Plc; IM Trust; UBS	Claro y Cia; Hogan & Hartson; Wachtell Lipton Rosen & Katz	Distribucion y Servicio SA	JPMorgan	Simpson Thacher & Bartlett		3,667
21-Oct-08	Itochu Corporation; JFE Steel Corporation; Kobe Steel Ltd; Nippon Steel Corporation; Nisshin Steel Co Ltd; POSCO; and Sumitomo Metal Industries Ltd	JPMorgan	Cleary Gottlieb Steen & Hamilton	Nacional Minerios SA (40% stake)	Goldman Sachs		Companhia Siderurgica Nacional	3,120
09-Oct-08	Criteria Caixa Corp SA	KPMG; Lazard	Garrigues	Grupo Financiero Inbursa SA de CV (20% stake)				2,146
04-Mar-08	StatoilHydro ASA	Not disclosed	Vinson & Elkins	Anadarko Petroleum Corporation (Brazilian Peregrino Project) (50% stake); and Anadarko Petroleum Corporation (Kaskida discovery) (25% stake)	*Advising seller:* Jefferies & Company; UBS	*Advising seller:* Fulbright and Jaworski; Tozzini Freire Teixeira E Silva Advogado	Anadarko Petroleum Corporation	1,800
11-Sep-08	Inversiones Telefonica Internacional Holding Ltda (subsidiary of Telefonica SA)	Not disclosed	Dewey & LeBoeuf; Guerrero, Olivos, Novoa Y Errazuriz; Not disclosed	Compania de Telecomunicaciones de Chile SA (55.1% stake)		Davis Polk & Wardwell		1,692
05-Mar-08	ArcelorMittal	Goldman Sachs		ArcelorMittal Inox Brasil SA (40.32% stake)				1,657
15-Dec-08	MAN AG	Goldman Sachs; Rothschild	Freshfields Bruckhaus Deringer; Machado Meyer Sendacz e Opice	Volkswagen Caminhoes e Onibus Industria e Comercio de Veiculos Comerciais Ltda	*Advising seller:* UBS	*Advising seller:* Clifford Chance	Volkswagen AG	1,608
12-Feb-08	AXA SA	UBS	Debevoise & Plimpton	Seguros Ing SA De CV	*Advising seller:* JPMorgan	*Advising seller:* Cleary Gottlieb Steen & Hamilton; White & Case	ING Group NV	1,500
24-Apr-08	Marubeni Corporation	JPMorgan	Skadden Arps Slate Meagher & Flom	El Tesoro (30% stake); and Esperanza (mining project) (30% stake)	*Advising seller:* Rothschild	Freshfields Bruckhaus Deringer. *Advising seller:* Clifford Chance; Sullivan & Cromwell	Antofagasta plc	1,310

Foreign Exchange Pass-through Passed By?

By Guillermo Mondino and Rodrigo Valdes (Barclays Capital)

- Inflation originating in recent FX movements has been lower than expected.
- In part, this is due to the deflationary consequences of the same shocks that caused the depreciation in the first place.
- This low pass-through may increase, if further FX weakness develops. But, thus far, what has already occurred should not be an obstacle to aggressive monetary easing.

An important argument against the possibility of central banks leaning against the wind in emerging markets downturns is the inflationary risk arising from the recent wave of exchange rate depreciations. For instance, Fitch ratings this week warned that central banks in LatAm should not cut interest rates aggressively precisely because of the risk it poses to the credibility of local central banks. So far, however, the inflationary effect has been minimal and central banks have begun to cut rates quite aggressively. Next week several CPI releases in the region will inform further whether this favorable trend continues. We expect benign releases in general, confirming that the inflation peaks are behind us. Moreover, in our view, there are good reasons to expect low pass-through of the depreciation already observed. However, we warn that results might be different if there is an additional leg of currency weakness.

Since late July 2008, currencies have depreciated considerably: BRL moved more than 30%, MXN close to 29%, and CLP and COP about 20%. Standard estimates of pass-through coefficients put in at least 10% the effect of a given depreciation on y/y inflation after a few months. This implies that, in principle, there should have already been considerable pressure on prices. Inflation, however, increased during H2, basically reflecting the transmission of the earlier food and energy prices shocks, not FX. In the past few months, core non-food goods (or core tradables, both of which are about 1/4 of CPI), the best candidate among CPI components to reflect the currency weakness, actually showed lower m/m SA monthly inflation, except in Colombia where, despite an increase, it remains tame (Figure 1). Overall, recent inflation readings have surprised on the low side because they have not reflected the historically feared pass-through pattern (see Tracking Inflation Surprises, January 28, 2009).

An important argument against the possibility of central banks leaning against the wind in emerging markets downturns is the inflationary risk arising from the recent wave of exchange rate depreciations.

Why is the 10% standard estimate not operating? Of course, depreciations do not happen in a vacuum. Both the shocks behind the downturn (lower commodity prices, lower global activity, risk aversion and USD strength) and the resulting monetary easing have weighed on LatAm currencies. Some of these same shocks have, however, helped contain the inflationary effects of the depreciation. This is substantially different from what would happen if the FX movement was a result of a collapse in confidence surrounding domestic policies.

There are at least three key factors this time around. First, the effective multilateral depreciations have been considerably lower than the USD bilateral ones as a good part of the price action is explained by USD strengthening. Second, plunging commodity prices have softened the blow on local prices, particularly in energy and food. Finally, the increasing economic slack as a result of a shocking adjustment in domestic demand and exports exerts a deflationary effect and lowers firms' capacity to pass higher costs to prices. Next week's industrial production in Brazil, which should contract close to 10% y/y, in our view, will be a good example of the magnitudes involved. The implication is straightforward: monetary policy should lean against the wind in this juncture – and there is plenty of room as policy stances had a contractionary bias to begin with. Aggressive easing should continue in the region.

The fact that passthrough has been small so far does not mean an additional leg of depreciation will not have

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Pass-through Passed By? (from page 9)

more noticeable effects. The empirical evidence suggests there are relevant non-linearities on FX effects on inflation. Mark-ups most likely already absorbed part of the shock and may not be able to take more. Furthermore, inflation credibility still plays a key role to contain second-round effects, and further depreciation could test it.

The first point is particularly important for Mexico as the currency has remained under pressure. Our call that Banxico will switch to a 75bp cut next meeting to front load the easing cycle may prove wrong if this trend continues, despite us downgrading the growth outlook considerably. We now expect GDP to contract 2.3% this year, even considering some recovery in H2.

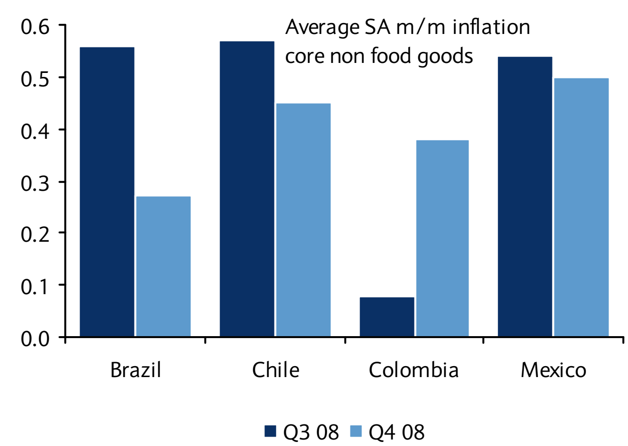
The credibility challenge is particularly important in Argentina, which has not yet implemented an increasingly needed depreciation, partly because the risks of de-anchoring are considerable.

Furthermore, the increasing perception of manipulation of official statistics adds to this risk.

The release of 2008 GDP statistics a full month ahead of schedule, and the most surprising strengthening of activity towards the end of Q4 08 in opposition to the dynamics witnessed in other countries further undermine the credibility of statistics. Indeed, industrial production was reported as having increased by 1.7% y/y, fully explained by a 14-year record in the food and beverages sector that grew 18% y/y. Without it, the industrial output drop would have been of 2.3% y/y. Similarly, while December's external trade releases omitted reporting quantities, exports collapsed by 24% and imports fell by 11%, further adding doubts over the source of the reported GDP growth. These surprising numbers spill-over the low credibility the authorities had in measuring inflation to activity numbers.

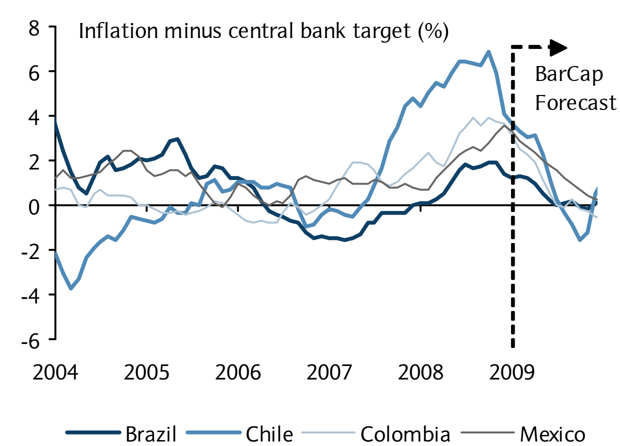
Latin America is in many ways treading through uncharted territory. The global shock is of disproportionate magnitude, yet policymakers in several countries have much enhanced credibility and improved macroeconomic frameworks. However, beyond the obvious questions about the scope of the shock, policymakers also face significant uncertainty over the true structural parameters that underpin their basic economic models (ie, pass-through coefficients) and about the potential non-linearities besetting them. For these reasons, which add to the unusual high headline inflation of 2008, policy responses have been slower to materialize. As data continue to come out in coming weeks, we expect policies to become bolder and further front load rate cuts. ❏

Figure 1. Passthrough not appearing despite last year FX adjustment…



Source: Local statistical agencies, Barclays Capital

Figure 2: … facilitating inflation towards the targets



Source: Barclays Capital

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Corporate Debt Restructuring in Argentina

By Eugenio Andrea Bruno
(Nicholson & Cano Abogados)

This year, large companies in Argentina are facing important principal and interest payments on debts taken out after the 2001 crisis. Some were taken out as part of the restructurings made between 2002 and 2006, and others in exchange for "new money" generated when the financial markets were opened to these companies, between 2005 and 2007. For example TGN, the large gas transportation company, has already announced the default on the payment of its bonds. La Serenísima, the large dairy company is, according various analysts on the brink of the default. Ausol, the toll operator of the Buenos Aires highway avoided default by obtaining a hike on the toll tariffs. Socotherm, the company dedicated to the casing of steel tubes, is restructuring syndicated loans. In the span of 2002-2006, Argentine companies and their debtors restructured corporate debt for an amount of approximately USD 20 billons. The principal cases of such restructuring were: Acindar, Aguas Argentinas, Autopistas del Sol, CableVisión, CTI Holdings, Disco, Edenor, Impsa, Impsat, Loma Negra, Mastellone Hermanos, MetroGas, Movicom, Pan American Energy, Petrobrás Energía, SanCor, Telecom Argentina, Telefónica de Argentina, TGN, TGS, Transener and YPF.

Usually the principal payments are refinanced, in the financial and capital markets, through new debt, and the proceeds used to repay the principal. Therefore, companies only make interest payments on their debts. Of course, the refinancing requires a demand for Argentine risk. But the cross-border financial and capital markets are closed, not only to Argentine companies but effectively now to all companies. Similarly, the domestic markets are also closed, with the addition that they usually are not deep enough to accommodate large-scale financial needs.

The international financial crisis is starting to hit the earnings of companies worldwide, including those from Argentina. Faced with a closure of the financial markets, Argentine companies would be required to use their own cash to make debt payments. But with a decrease in their earnings, that is very unlikely.

It is usually recommended that a company facing financial distress act as soon as the first signs of financial distress appear. Depending on the severity of its financial distress, a company may begin pre-default workouts.

If the pre-default workouts attempts are not successful or the financial difficulty more severe, and the company is forced to default, then it should carry on with post-default restructurings.

Companies facing more severe financial problems used more drastic restructurings, reducing both the principal of the debt instruments and the interest rate.

Under the terms of most bank loans and international bonds issued by Argentine companies, failure to pay on time, in the agreed currency, constitutes an event of default. In this case, creditors representing 25 percent of the principal amount of the outstanding debt have the right to accelerate the term of the loans and bonds, and declare all sums immediately due and payable.

Several of the mechanisms used in bank restructurings in the US and Europe have been used before in Argentina, and as such the country demonstrates important experience that should be taken into account before companies respond to financial distress.

Debt Repurchases

One method commonly used was the repurchase of debt. Argentine companies used two basic mechanisms: purchases in the open markets, made through selected and private transactions; and tender offers, addressed to all holders. Debt repurchases may be made on a private basis through one or more transactions with separate bondholders on terms and conditions that may be agreed on freely by the buying debtor and the selling bondholder. Also, the terms and conditions of these transactions may differ. However, if the debtor desires to make an across-the-board, public bond repurchase it must also make a tender offer, offering the same terms and conditions to all bondholders. Syndicated banking loans are treated differently, because the debtor must agree to the terms of the repurchase with all members of the syndicate.

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Waiver Solicitations

To gain relief from temporary liquidity problems, Argentine companies used waivers from compliance with restrictive covenants written into the debt documents. Waivers are typically requested for a finite period of time, during which the company's management hopes that its financial condition will stabilise and improve. Otherwise, the company may be able to negotiate a more comprehensive restructuring of its balance sheet. The instrument to implement waivers for bonds are consent solicitations.

Covenant Modification (Amendment of Non-payment Terms)

Bank loans and corporate bonds typically require the unanimous consent of each of the affected creditors in order to amend the debt's payment conditions.

Amendments might include: reductions in principal, reductions in the interest rate, an extension of time for payment of interest or principal, or a change to the currency in which payments are to be made. In addition, both loans and bonds also frequently include financial and operating covenants that restrict various activities of the debtor, and typically these covenants may be amended and reduced by a vote of bondholders holding at least a majority of the aggregate principal amount of bonds outstanding. Various Argentine companies amended basic financial covenants to make them more consistent with the financial reality they faced after the crisis, as compared with the condition at the time of the debt's arrangement.

Pure Refinancing

Some Argentine companies only refinanced the maturity dates of the payments under their debt. In this case, they either amended the bonds' and loans' payment terms or made exchange offers. In this case, the debtor offers bondholders an exchange of the original debt for new debt with extended payment dates. The usual threshold for the exchange to be effective was 90 percent of the original debts principal. The object of an exchange offer is to restructure the debt to fit a company's current financial profile. A condition to every exchange offer is that it will only take effect if holders of a majority of the aggregate outstanding principal amount of the bonds exercise their option to accept the new bonds. However, bondholders do not have an obligation to accept the new bonds. Most exchange offers are coupled with exit consents, whereby creditors accepting the exchange offer vote to change the terms of the old bonds as they discard them. Exit consents are used quite frequently in the US to encourage other creditors, who may hold out and refuse to tender their bonds, to accept the exchange offer so that they are not left with diminished bonds.

Debt-to-Equity Exchange

Capitalisation of debt, often called "debt-to-equity exchange" was another restructuring mechanism used in Argentina. Under this type of exchange, the debtor issues shares to its creditors as a cancellation of the debt.

Another very popular instrument used in Argentina was the Acuerdo Preventivo Extrajudicial (APE), which consists of an agreement among the debtor and creditors representing at least 66 percent of the principal of the debt subject to restructuring.

Restructuring with Principal "Haircut" and Interest Rate Reductions

Companies facing more severe financial problems used more drastic restructurings, reducing both the principal of the debt instruments and the interest rate.

In the case of bond debt, the mechanism mainly used was the issuance of the so-called "discount" debt securities in exchange for the original debt.

Effectively, debtors used exchange offers with exit consents.

Regarding loan debt, the debtor and bank creditors amended the loan agreements to reflect a reduction in the principal amounts due. This principal "haircut" was usually accompanied by a decrease in the interest rate.

Contractual-judicial Restructurings (APE)

Another very popular instrument used in Argentina during the crisis was the so called Acuerdo Preventivo Extrajudicial (APE), which consists of an agreement among the debtor and creditors representing at least 66 percent of the principal of the debt subject to restructuring, and 51 percent of the creditor headcount, which is submitted to court approval. The court only controls the compliance with certain formal aspects, including ensuring the minimum percentages are reached. If those aspects are complied with, the court approves the APE, and it becomes binding to all creditors, including those that did not participate in or even rejected the APE.

Judicial Reorganisations

The last resort for Argentine companies has been the use of judicial reorganisations under local bankruptcy law, using proceedings that have some similarity to the proceedings under the Chapter 11 of the US Bankruptcy Act. ❑

Investing in Brazil – Latin America's Powerhouse

The Country Remains an Attractive Investment Target

By Sergio Sardenberg and Francisco A. Fabiano Mendes

The current financial meltdown has impacted other countries in different ways and varying degrees. The extent of the damage abroad has been a function of the greater or lesser vulnerability of national economies to external influences and their degree of interrelation with, and/or dependence on the U.S. economic/financial system.

As such, a determination of such factors is a must in the process of searching for good investment opportunities abroad.

It is the contention of this article that Brazil remains an excellent target for foreign investment, given the resiliency and breadth of its booming economy, which has become the tenth largest in the world. With a 1.31 trillion-dollar GNP – just below Canada (1.44 trillion)

It should be mentioned, as a preliminary consideration in an analysis of the status of the country's economy that Brazilian banks operate under a set of strict regulations that have had an inhibitory effect against unorthodox, risky financial practices, such as the subprime operations.

Brazil's strong economy has been the subject of a number of recent media reports, notably in a first-page piece in the Washington Post, on November 15 on the recent gathering of world leaders to discuss the international financial crisis ("As Summit Starts, Emerging Nations Weigh New Clout-Brazil, China, India Step Up in Diplomatic Power Shift," by Anthony Faiola and Glenn Kessler), wherein it is reported that "developing countries are expected to account for nearly 100 percent of global growth next year, as developed countries fall into a recession."

The article states further that "Overall developed economies are projected to contract by o.1 percent, according to new estimates released by the World Bank." (stress added)

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In another recent text in the same newspaper ("In Brazil, Whiplash on Assembly Lines,") by Joshua Partlow, on December 1st, which focused on the production downturn in the Brazilian auto industry – particularly at the GM of Brazil plants-it is rendered clear that what actually took place was a cooling down of a record-breaking spurt of industry-wide production over the last two months. Furthermore, the article explains that the cutback did not amount to "a crash, or even a crisis, but rather a collective whiplash, a sharp lowering of expectations," and it was "the first monthly decline for the industry in five years." (stress added)

The extent of the damage abroad has been a function of the greater or lesser vulnerability of national economies to external influences and their degree of interrelation with, and/or dependence on the U.S. economic/financial system.

The article reports, further, that the Brazilian government has provided a $35 billion aid package, in the form of an indirect financial stimulus, designed to reinforce banks which, in turn, provide loans to prospective car buyers.

The text also alludes to the belief of local experts, to the effect that "the country's burgeoning and diversifying economy is better prepared to fend off a U.S. – generated crisis than in earlier years. (stress added)

It should be noted, in this respect, that the great majority of car sales in Brazil are made to the domestic market, in contrast – for example - to what happens in Argentina, where 60% of such sales are made to international markets.

Estimates by official and private local experts are reportedly stating that "the Brazilian auto-market is still expected to grow by double-digit figures over last year's results," according to Mr. Jackson Schneider, the president of Brazil's carmakers' association, as quoted in the article. (stress added)

Brazil's rise to prominence in the international economic/financial market, to the position of one of the

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world's most attractive targets for investment was the result of the adoption, by three successive administrations, of a cautious, orthodox economic policy.

In terms of political development, Brazil managed to make a smooth transition from a twenty-year period of dictatorship in the 60's to a democratic order and, in the process, to adopt an advanced constitution that provides strong safeguards for the preservation of the rule of law, for fair practices and the protection of individual and collective rights.

A chronic dependence on foreign oil has been overcome in large part by tapping very deep water deposits along the South/ Southeast coastline, which hold the promise of turning the country into a major oil exporter. (Incidentally, Petrobras, the world's eighth largest oil company, has developed the most advanced technology for deep and very deep water prospecting and extraction operations).

Another significant contributing factor to the goal of energy self-sufficiency has been the hugely successful alcohol ethanol program which, contrary to some misguided reports, is not detrimental to the production of food staples, since only 1% of the country's arable land-most of it in the wealthiest state-São Paulo – is utilized for the production of this natural, non-pollutant fuel.

Cautious investors do not limit the scope of their analysis about offshore investment opportunities to business data. They take the pulse of the economy as a whole and familiarize themselves with the target country's basic institutions, so as to ascertain whether or not – and to what extent – the rule of law prevails and the judicial system provides effective protection for business interests and other segments of society.

As such, we provide herein a broad overview of Brazil's progress in some key areas, as a sort of snapshot that shows the country's constitutional safeguards, recent far – reaching reforms of the judicial apparatus designed to make it more effective, swifter and egalitarian, as well as the progress made in the effort to lower disparities among economic classes, promote full employment, growth at grass-roots levels, and expand renewable energy sources.

The State of the Economy

The Brazilian economy's prospects are highly encouraging, despite the current international crisis.

External reserves have reached a record 195.2 billion dollars (in 2000 they stood at 32 billion).

This unprecedented event has made it possible for the administration to announce, last February, that Brazil had paid its foreign debt in full. Gone is the usual – and significant - indebtedness to the IMF – a fixture of the country's finances for many decades.

Meaningful Indicators

A recent upgrade in the Standard & Poor's index rating of Brazil's sovereign debt to investment grade (BBB) constitutes a clear evidence of the maturity of its economic policies.

A second investment grade certification was given by the Canadian agency DBRS, citing the consistency of the country's economic policies, which were deemed to denote a capable economic/financial management team. Specific pluses mentioned were the improvement in public collection, in the size and quality of the public debt and a positive status in connection with foreign accounts.

- ***GNP*** is at R$2,6 trillion (approximately $1.625 trillion).

The United Nations Conference on Trade and Development has rated Brazil as the 5th most attractive country for outside investment.

It has been growing steadily for the last 24 quarters. The growth rate of the economy in the second quarter of 2008 was 6.1%. This result has led the Finance Ministry to estimate an overall expansion of 5.5% for all of 2008. The 2007 rate was 5.4%. This performance should boost investors' confidence, particularly when contrasted with a gloomy 1.4% forecast for the whole of the European Union.

- ***Per capita GNP*** is R$13,5 thousand (app. $8.437).
- ***Inflation*** remains low, at an average 4.6% for the last 12 months.
- ***New job positions:*** 10.5 million. The average annual jobless rate has reached a record low of 9.3%.
- Domestic family ***consumer expenditures:*** R$ 1,6 trillion over the last 12 month period.
- ***Foreign Direct Investment*** $34.6 billion in 2007 (almost double the 2006 amount).
  Two-month total in '08 (Jan./Feb.): R$5,7 billion.

The United Nations Conference on Trade and Development (UNCTAD) has rated Brazil as the 5th most attractive country for outside investment.

- ***Brazilian investment abroad:*** $7 billion in 2007
- ***Primary Surplus:*** 6.22 of the accumulated GNP in 2008 (Jan/Feb)
- ***Trade Balance:*** Exports: $165.3 billion (alltime high)
  Imports: $131.2 billion (alltime record)
- ***Industrial Output:*** Feb. 08: 9.7% growth compared with the same month in 07.
- ***Agriculture***: 133.1 million tons in grains in 2007. Another alltime high.

The European Union has lifted all restrictions on importation of Brazilian meat products, a major export item.

Percentage of formal job positions: 54.6% last February. (Best result since 2002).

This means that 11.5 million workers, from a gross total of 21 million are registered. (It is a significant item in the light of the high percentage of unregistered workers that has characterized Brazilian job markets. Since the number of workers that comprise the so-called informal job market has always been a matter of concern, a large increase in the number of registered workers is a highly encouraging development. Among other positive effects, the rise in the number of formal employees has brought about a drop in the amount of the social security deficit.)

The 36% increase in job offers over the preceding year is attributed to the expansion of the economy in general and, more specifically, to an increase in outsourcing activity.

The expanding job market encompasses the country's six main metropolitan areas , as follows: 1.São Paulo; 2. Rio de Janeiro; 3. Belo Horizonte; 4. Recife; 5. Porto Alegre and 6. Salvador.

Joblessness at Alltime Low

A most gratifying and significant development – particularly in these times of global financial crisis – is the fact that the jobless rate has dropped to a record low: 6.8% (as contrasted with 7.4% in December, 2007) and the lowest point in 27 years.

Even though it is speculated that this number may change, this prospect cannot dim the significance of this milestone.

Generating New Consumers

An unprecedented economic phenomenon, akin to a veritable peaceful revolution has taken place in Brazil in the last two years: the emergence of a large middle class made up of people rising from the lowest classes in the economic scale (classes D and E) and entering class C, which encompasses regular consumers.

All told, some 20 million Brazilians have ascended to Class C, a number that roughly corresponds to the population of Chile.

This unprecedented development, which has spurred the economy by adding such a significant number of new consumers – and taxpayers – is in large part a result of a good stewardship of economic policy, as well as a product of government programs such as the hugely successful "Bolsa Família" (Family Scholarship) program of financial assistance to poverty-stricken rural families that meet a strict and rigorously enforced commitment to keep their children in school and take them to a doctor and a dentist for regularly-scheduled appointments.

The end result of such programs has been the generation of wealth at a grassroots level, which in turn, has created new consumers, boosted the economy of rural towns and federal and local tax revenues.

The Rule of Law, Democracy and Individual Rights

The new Constitution sets forth a long list of specific basic guarantees.

Title I, Article 1 sets forth the fundamental principles that govern the nation, which is defined as "a legal democratic state, founded on the principles of:

I sovereignty;
II citizenship;
III the dignity of the individual;
IV the social values of work and free enterprise;
V political pluralism.

The Brazilian Judiciary is in the process of carrying out a number of significant, far-reaching and creative reforms.

Sole paragraph – All power emanates from the people, who discharge it either through elected representatives or directly, as provided in this Constitution."

Article 3 sets forth the country's internal policy goals, as follows:

Article 3 – The fundamental objectives of the Federal Republic of Brazil are:

I to build a free, just and solidary society;
II to guarantee national development;
III to eradicate poverty and marginal living conditions, and to reduce social and regional disparities;
IV to promote the well-being of all, free of any prejudice as to aspects of origin, race, sex, color, age and other forms of discrimination."

The following principles are enshrined in the constitutional text:

-the prevalence of human rights;
-non-intervention in other countries;
-the defense of peace;
-the peaceful resolution of conflicts;
-the repudiation of terrorism and racism;
-the granting of political asylum.

Thus, Brazil meets the basic needs of outside investors for a legal environment where there is ample recognition of basic rights and a court system that provides due enforcement of those rights. It can be stated, unequivocably, that the Rule of Law prevails within its borders.

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The New Dynamics of the Judiciary

The Brazilian Judiciary is in the process of carrying out a number of significant, far-reaching and creative reforms, designed to modernize it from its top echelons and implement effective means of reducing a severe backlog of cases.

Indeed, 2007 and 2008 are bound to be remembered as a turning point in Brazilian judicial history, starting with the introduction, by the country's highest court, the Federal Supreme Court (STF), of the "Súmula Vinculante," a type of uniform ruling that is binding upon all other courts, as well as on administrative agencies, and which is designed to liberate the STF from having to rule on appeals dealing with legal issues previously decided by the court in an uniform manner. It is a revolutionary development in that it applies the Common Law concept of "stare decisis" in a Civil Law jurisdiction. The "Súmula Vinculante", introduced in late 2007, has turned out to be a great success. Since then the STF has already issued thirteen "Súmulas Vinculantes."

Another valuable tool is the adoption by the STF of the concept of "general repercussion," whereby the court only hears those appeals entailing a discussion of issues relevant to society at large, from a socio-economic and juridical standpoint, i.e. which affect not only the parties to the action, but also a great number of people in a given community or in the country at large.

The relevancy factor is examined by the justices as a first-order of business and, should the case fail to meet that test, the appeal is filed away without a decision on the merits.

On the other hand, whenever the subject matter of an appeal meets the relevancy test, the STF will hand down its decision, which will have a binding effect on all other lawsuits dealing with the same issues, at all levels of the judicial system.

The Superior Justice Court (STJ), the country's second highest after the STF, that hears matters that do not entail constitutional issues, has likewise benefited from a new law, which introduces changes in provisions of the Code of Civil Procedure, whereby the court may disallow "repetitive appeals," i. e. those which raise issues that have already been uniformly decided by the Court.

These extensive measures are the product of a broad reform of the Judiciary mandated by Constitutional Amendment n°45, regulated by Law n° 11.418/2006.

In addition to such conceptual changes, a number of practical procedures have been instituted, in order to expedite the work of the courts, a significant one being the introduction of the filing of appeals by electronic means-all the way up to the STF.

The reforms have been well received, not only by the members of the legal profession and public officials, but also by the population at large-particularly those who have felt the need for a more expeditious judicial apparatus.

The aforementioned Constitutional Amendment n°45 added a new item (LXXXVII) to the list of basic rights set forth in Art.5, as follows:

> *"Everyone is entitled to a reasonably swift judicial or administrative process and the means of ensuring this expeditiousness."*

The pursuit of a speedier dispute resolution system has also led to a number of initiatives, such as the following:

Arbitration – A law regulating the matter was passed in 1996 (Law n°9.307). A recent bill of law requires that the parties to a legal action be notified of the availability of arbitration as a means of dispute resolution.

The most common use of arbitration has been in business disputes.

Choice of Court - A manner of minimizing delays that has been increasingly utilized-particularly by business entities-is to take advantage of the fact that Brazilian law allows a change of venue by agreement of the parties. It has become increasingly common, for instance, for the parties to disputes originating in São Paulo (which is plagued by court delays), to opt for the Rio de Janeiro courts, which are known to be swifter, no doubt due to lower case loads.

A recent news item that serves as a kind of footnote to the above text on judicial independence and legal protection for all individuals is a court decision to the effect that President Lula da Silva's remarks at a political rally in the State of São Paulo were detrimental to the public image of a former mayor of the city of Campinas and awarded plaintiff "moral damages" (equivalent to pain and suffering).

Attempts by the President's attorneys to reduce the amount of the award were denied by the lower court and the latter's decision was upheld by the STJ. The fact that a common citizen may prevail in a suit against the President, collect damages and have the judgment upheld by the highest court surely speaks volumes about the openness of Brazilian society and the prevalence of the rule of law.

The Expanding Energy Sector

The sugar-cane ethanol business has become a very profitable endeavor, due to a vast and continuously expanding market. Its raw material yields not only ethanol, but also sugar and molasses, and the "waste" material, the bagasse, is an excellent fertilizer. Total ethanol production is 22 billion liters a year.

Alcohol ethanol entrepreneurs have branched out, within Brazil and elsewhere, in search of new business opportunities.

Cosan, the largest ethanol plant, has recently bought ExxonMobil's Brazilian subsidiary, Esso Brasileira de Petróleo, for a sum of a little under one billion dollars, thereby acquiring, among other things, a network of over 1,500 gas stations, a lubricant plant and a petroleum maritime terminal in Rio's Guanabara Bay. It is an acquisition that fits in well with Cosan's strategy of achieving a vertical integration of its operations, as well as with ExxonMobil's decision to divest itself of its Latin American distribution networks, in order to concentrate on oil exploration and production.

PETROBRAS, in turn, is engaged in a project involving a long-distance (1,150 km) ethanol pipeline that is scheduled for completion by the end of 2009 and is budgeted to cost approximately $1 billion. Output is expected to reach 12 million cubic meters a year. The product will be transported to two terminals, one in the State of São Paulo and the other in Rio de Janeiro.

The aim of the project is to provide an outlet for the ethanol production of the landlocked Western states of Mato Grosso and Minas Gerais. It is managed by PMCC, a three-party joint venture company, the other partners being the giant construction company Camargo Correia and Japan's Mitsui group.

This posture illustrates an interesting form of tripartite collaboration, that has become common lately for large-scale projects, joining government owned and private companies, (domestic as well as foreign)

Another PETROBRAS endeavor is an overhaul and expansion of its tanker fleet (which comes under the purview of its transportation subsidiary, FRONAPE ("Frota Nacional de Petroleiros").

A second pipeline, originating in the state of Mato Grosso do Sul and ending at the port of Paranaguá in the Southern State of Paraná, a distance of 900 km, is in the planning stage at the Ministry of Mines and Energy and at PETROBRAS.

The ethanol phenomenon fits in well with the Brazilian policy of boosting renewable energy sources, as opposed to non-renewable ones. Alcohol ethanol and hydroelectric power plants have together attained a participation level of 46.4% of the total of the country's various sources of energy (up from 44.9% last year), while petroleum and other non-renewable sources have accounted for a total of 53.6% (down from 55.1% in 2006).

Among renewable energy sources ethanol (16%) has surpassed hydroelectric power (14.7%). The total participation of all other renewable fuel sources rose from 2.9% to 3.1%.

The Simplício hydroelectric plant abuilding in the Paraíba do Sul River on the border between the country's two major states, São Paulo and Minas Gerais, at an estimated cost of 1.6 billion reais, is expected to supply 3.37 MW to an area that has a population of 14.3 million people.

Two significant projects will be launched in the Madeira River, in the Amazon Region. The first one, the Santo Antonio plant, is projected for an installed capacity of 3.168 MW and will require an investment total of R$9.2 billion – It is expected to start operations in 2012.

The second plant is Jiráu, projected for a capacity of 3.326 MW and entailing an investment estimated at R$9.2 million. It is scheduled to be operational in 2013.

PETROBRAS has announced plans to spend up to $30 billion for the acquisition of 40 drilling ships and platforms in the next decade in order to expand oil and natural gas exploration and drilling, as well as other operations, such as refining.

The company will call for public biddings, open to both local and foreign participants.

A manner of minimizing delays that has been increasingly utilized-particularly by business entities-is to take advantage of the fact that Brazilian law allows a change of venue by agreement of the parties.

Preventive Measures

Notwithstanding the fact that the Brazilian economy has been able to avert a serious financial crisis, federal and state authorities, acting in tandem with the leadership of industrial, trade and financial associations and labor unions, have taken a number of economic and financial sectors.

Those measures have included, among others, the following:

- a program to revamp and maintain some 20,000 km of highways, corresponding to about one-third of the country's federal highway grid, at an estimated cost of R$2.6 billion;
- a plan to assist the country's civil construction industry that includes substantial credit outlays through the banking system;
- an initiative to invest 350 billion reais in popular housing for families having an average income of up to five monthly minimum salaries. Following a meeting with civil construction association leaders federal officials agreed to increase the budgeted outlay, in order to include an additional 300,000 housing units.

The robust state of the Brazilian financial and economic sectors is largely attributed to the prudent stewardship of the Lula administration's team of Finance Minister Guido Mantega and Central Bank chief Henrique Meirelles, who have given continuity to the successful policies

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of the former administration of President Fernando Henrique Cardoso, which succeeded in putting an end to a hyper-inflation in the 1990's and revamped the Brazilian economy and set the stage, so to speak, for its wide-ranging expansion in the current administration.

Mr. Meirelles, a former banker is widely respected in international financial circles.

The best indication that the current administration is doing a good job is in the fact that President Lula's approval rating was at 84% in December.

Brazil has adhered to the basic financial guidelines agreed-upon at the two rounds of international financial gatherings in BASEL, Switzerland - known as Basel I and II – and Brazilian banks have followed the guidelines set in those conferences (particularly Basel II) pertaining to prudent credit outlay safeguards and, as such, stayed clear of risky operations, such as the subprime mortgage loans.

Afterword

The flurry of activity described in this article and the progress achieved in the basic and most diverse sectors of Brazilian life all lead to the conclusion that the country has, so to speak, come of age.

Brazilians have long had a conflicted view of their country. On the one hand they sensed that such a vast land, endowed with an abundance of natural riches, was destined to become an advanced and prosperous nation while, on the other hand, it seemed that its economic, financial and administrative shortcomings would relegate it to a perpetual state of underdevelopment.

A great Austrian writer, Stephan Zweig, who took refuge in Brazil from Nazism and became fascinated with his new home, gave voice to that aspiration in a prescient book titled "Brazil Land of the Future."

Though appreciative of Zweig's vision, Brazilians, expressing skepticism, would say: "Yes, except that this future never comes!"

Now it seems clear that Zweig was right and that the future, at long last, has arrived.

Although international financial crises may buffet markets around the world, it should be heartening to foreign investors to know that the Brazilian economy's new maturity and its reinforced underpinnings make it more resilient and thus better able to weather such storms. All things being relative, Brazil is now better able to offer attractive investment opportunities than the majority of developing markets.

The President's rededication to those rights and duties should have the effect of establishing a strong new bond between the US and Brazil, given the hereinabove mentioned fact that the Brazilian constitution is a forward-looking document that sets the framework for the Rule of Law that characterizes the Brazilian society.

"President Barack Obama, alluding in his inaugural address to the Founding Fathers who "drafted a charter to assure the rule of law and the rights of man" sent a message "to all other peoples and governments" that "America is a friend of each nation and every man, woman and child who seeks a future of peace and dignity, and we are ready to lead once more."

The President's rededication to those rights and duties should have the effect of establishing a strong new bond between the US and Brazil, given the hereinabove mentioned fact that the Brazilian constitution is a forward-looking document that sets the framework for the Rule of Law that characterizes the Brazilian society. ❏

LBO No Longer an Option in Brazil

By Elizabeth Johnson

With the international credit crisis, the brief window during which private equity funds had the option to do leverage buyouts has closed. With credit market tight, maturities down and borrowing costs on the rise, private equity funds expect acquisition structures to change. However, there is a consensus that it is a positive moment for funds, especially those that raised capital in 2008.

According to Mario Malta of Advent International, the new scenario will result in a change in acquisition structures. The fund took advantage of improved borrowing conditions to finance acquisitions in recent years, but does not expect to use leverage in upcoming acquisition. “We have a lot of capital to invest from our LAPEF IV fund,” said Malta. He added that he expects sellers to be required to offer partial financing for deals. “Part of the acquisition prices will be made in cash, but we also expect to see resurgence in the use of seller’s notes,” Malta said.

Malta said that the fact that companies no longer have access to lines of credit, private equity funds will become a more attractive option for some firms. Malta added that the lack of capital in the market could also lead to more realistic valuations.

Nemer Rahal, a partner at Patria Investimentos, agrees. “The market is favorable for private equity and companies are going to be more open to receiving backing from funds,” he said. Raha added that Patria will assume there will be no leverage available for acquisitions in the near future. He added that given the scarcity of capital available, the scenario is very positive for those with money. “There are many opportunities and we will continue to follow the model that has worked for us in the past,” he added.

Business as Usual

With the highest interest rates in the world, Brazilian funds never became accustomed to using leverage to acquire portfolio companies. As a result, this new scenario is little more than a return to the modus operandi of recent years.

“We bought all of our companies without leverage. Until recently, there was no funding available to buy companies – interest rates were too high and lending periods were too short,” said Luiz Francisco Novelli Viana, a founding partner of São Paulo-based private equity fund TMG.

Although Brazilian firms did use some debt to make acquisitions in recent years, fund managers were conservative in their approach to leverage. In 2007, for example, when GP Investments acquired Pride International’s Latin American Land Drilling and E&P Services businesses for US$1 billion - one of the largest leveraged buyouts in Brazil - the fund opted to finance only 60% of the acquisition price. ❑

Elizabeth Johnson is a reporter for Venture Equity Latin America, also published by WorldTrade Executive, Inc.

The Public Offer of Securities Distributed with Restricted Efforts in Brazil

By Walter Stuber and Adriana Maria Gödel Stuber (Walter Stuber Consultoria Jurídica)

On January 16, 2009, the Brazilian Securities and Exchange Commission (Comissão de Valores Mobiliários - CVM) issued CVM Instruction No. 476, which contains the current regulations on public offers of certain securities distributed with restricted efforts and the negotiation of these securities in the Brazilian regulated markets. The new regulations do not apply to private offers of securities. CVM Instruction 476/2009 cover only to the following securities: (i) commercial paper; (ii) banking credit bills without liability of a financial institution; (iii) debentures non-convertible or non-exchangeable into shares; (iv) units (quotas) of closed-end investment funds; and (v) real state or agribusiness receivables certificates.

Therefore, shares or any other types of securities are not benefited with the same treatment and are subject to CVM Instruction No. 400, of December 29, 2003, which regulates the public offers for the distribution of securities in primary and secondary markets.

Save for those few exceptions expressly provided for in CVM Instruction 476/2009, public offers distributed with restricted efforts are not subject to CVM Instruction 400/2003 nor governed by any other CVM rules which contemplate the procedure to be followed for distribution of specific securities in the Brazilian territory.

The public offers distributed with restricted efforts shall be exclusively destined to qualified investors and intermediated by participants of the Brazilian securities distribution system[1]. The regulations expressly prohibit the search of investors through stores, offices, or establishments open to the public, or with the use of mass or electronic media (pages or documents on the worldwide web or other open computer networks and e-mail), and any form of communication directed to the general public.

In public offers distributed with restricted efforts, it is allowed the solicitation of up to 50 qualified investors and the offered securities shall be subscribed or acquired by no more than 20 qualified investors. For the purpose of this limit, investments funds whose investment decisions are taken by the same manager shall be counted as one sole investor.

The following investors are deemed to be "qualified investors":

(i) financial institutions;
(ii) insurance companies and capitalization societies;
(iii) private welfare opened or closed capital organizations;
(iv) individuals or legal entities that hold financial investments in an amount superior to R$ 300 thousand, attest in writing their qualified investor condition and subscribe or acquire, in the offer, securities in the amount of at least R$ 1 million;
(v) all investment funds, regardless as to whether they are directed exclusively to qualified investors or not. This means that investment funds destined to non-qualified investors are also considered qualified investors;
(vi) portfolio administrators and securities consultants authorized by CVM, in relation to their own monies; and
(vii) social security regimes instituted by the Federal Government, by the States, by the Federal District or by Municipalities.

As a general rule, no public offer shall be distributed on the Brazilian securities market without prior registration with CVM2.

As a general rule, no public offer shall be distributed on the Brazilian securities market without prior registration with CVM[2]. However, public offers distributed with restricted efforts are automatically waived of this registration.

In public offers distributed with restricted efforts, the subscribers or acquirers of the securities shall furnish, in writing, a statement certifying that they are aware that: (i) the offer was not registered with CVM; and (ii) the offered securities are subject to the negotiation restrictions provided for in CVM Instruction 476/2009.

The closing of the public offer distributed with restricted efforts shall be notified to CVM by the lead intermediary institution by means of a Distribution Closure Notice within a five-day term counted as from the closing date. The Distribution Closure Notice shall be published in the CVM webpage in the form of Exhibit I to CVM Instruction 476/2009, and must have the following information: company name, number of enrollment with the Taxpayers´ Corporate Register of the Ministry of Finance (CNPJ/MF), corporate type and website of

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the Issuer (the entity responsible for the offer) and of the Issuing Company (the entity which issues the securities), if the Issuer and the Issuing Company are different legal entities; name of the lead intermediary institution and of other intermediary institutions involved with the distribution, if any; and the data of the offer (quantity of offered securities, type, class, form, price per unit, total amount subscribed or acquired in the offer; date of start of the offer, date of closing of the offer and final data for placement).

In the event that the offer is not closed within a period of six months after its start, the lead intermediary institution shall notify to CVM only the available data, and furnish the additional data every six months until the closing.

The Issuer cannot make another public offer of the same type of securities issued by the same Issuing Company within a four month-term counted as from the date of closing of the original offer, unless the new offer is submitted to registration with CVM. This restriction is not applied, however, to the offers of real estate or agribusiness receivables certificates of the same securitization company linked to credits segregated in different assets by means of a fiduciary relationship (regime fiduciário)[3].

Regarding the obligations of the participants of an offer, the Issuer and its administrators must furnish to the investors true, consist, accurate and sufficient information about the transaction.

The lead intermediary institution and its administrators will have the following duties:

(i) to take all caution and to act pursuant to high standards of diligence, responding for the lack of diligence or omission, assuring that the information rendered by the Issuer be true, consistent, accurate and sufficient, in order to allow the investors to undertake a reasoned decision with respect to the offer;

(ii) to disclose to the investors eventual conflicts of interest;

(iii) to be sure that the investors have sufficient knowledge and experience in finance and business to evaluate the quality and the risks of the offered securities;

(iv) to be sure that the investment is adequate to the level of sophistication and the risk profile of the investors;

(v) to obtain from each investor (subscriber or acquirer of the securities) a statement declaring that the investor is aware that the offer was not registered with CVM and that the offered securities are subject to the negotiation restrictions provided for in CVM Instruction 476/2009;

(v) to immediately suspend the distribution and notify the fact to CVM, in case any irregularity is identified;

(vii) to send the Distribution Closure Notice to CVM notifying it about the closing of the offer within five days counted as from the closing date; and

(viii) to keep for a period of five years all the documents regarding the public offer process, including documents which evidence the above-mentioned duty of diligence.

In the event that the offer is not closed within a period of six months after its start, the lead intermediary institution shall notify to CVM only the available data, and furnish the additional data every six months until the closing.

The Issuing Company, the Issuer, the lead intermediary institution and any other intermediary institution involved in a public offer distribution with restricted efforts shall be subject to the same norms of conduct that are required in any public offer[4]. The applicable norms of conduct are the following:

(i) while the public offer has not been released to the market, it is mandatory to limit: (a) the release of information related to the offer to what is necessary for the objectives of the offer by alerting the recipients of the reserved character of the information transmitted; and (b) the use of the reserved information strictly to the purposes related to the preparation of the offer;

(ii) up to the delivery of the Distribution Closure Notice, it is necessary to abstain from negotiating with securities issued by the Issuing Company or the Issuer, except in the case of: (a) execution of a stabilization plan duly approved by CVM; (b) total or partial disposal of securities lot that is the object of firm commitment; (c) negotiation for the account and order of third parties; or (d) operations clearly meant for accompanying a certificate or receipt of securities;

(iii) to abstain from communicating in the media about the offer or Issuer until the issuance of the Distribution Closure Notice; and

(iv) from the moment the offer becomes public, when releasing information related to the Issuer or offer: (a) to observe the principles relative to the quality, transparency and equality of access to information; and (b) to clarify connections with the Issuer or its interest in the offer, as well as its communication on subjects that involve the offer, the Issuer, or the securities.

There are restrictions for the negotiation of these offered securities distributed with restricted efforts. The offered securities cannot be traded in the Brazilian regulated markets within a term of 90 days counted as from their subscription or acquisition by the investor. After this

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Restricted Efforts in Brazil (from page 21)

period, the securities can be traded on the organized and non-organized Over-The-Counter (OTC) markets, but not on the Stock Exchange, without the need to register the Issuer with CVM[5]. Should the offered securities be units of an investment fund, these units can only be traded on the organized and non-organized OTC markets if the investment fund is duly registered to operate with CVM.

The negotiation of the offered securities must be exclusively made between qualified investors. However, this restriction would cease if the Issuer is registered or applies for registration with CVM and presents to CVM a prospectus under the terms of the applicable regulations.

The intermediary entities involved with the distribution will be responsible for the compliance of the above-mentioned restrictions, whenever the securities are traded on the organized and non-organized OTC markets.

The Issuer and its controlling shareholders and administrators shall:

(i) prepare financial statements at the end of each fiscal year and, whenever is the case, consolidated statements in accordance with the Brazilian Corporate Law (Law nº 6.404, of December 15, 1976) and with due regard to the specific rules issued by CVM;

(ii) submit its financial statements to auditing by an independent auditor or auditing firm duly registered with CVM;

(iii) disclose its financial statements, accompanied by explanatory notes and an opinion of independent auditor or auditing firm, in the company´s webpage within three months after the end of the fiscal year and keep these documents for a term of three years available at the same webpage. This information shall also be immediately sent to the entities which administrate the markets in which the offered securities are admitted for trading;

(iv) obey the duty of confidentiality and the negotiation prohibitions contained in CVM Instruction nº 358, of January 3, 2002[6]. The controlling shareholders and administrators of the Issuer are under the obligation to keep confidential information related to any material event (as defined below) to which they have privileged access due to the position they hold, until its release to the market, as well as to ensure that subordinated and third parties of their trust also do it, and they shall be jointly and severally liable for the release of information in the case of disregard. Before the release of the material events taken place in the company's businesses to the market, the negotiation with the offered securities is expressly prohibited and cannot be done by the controlling shareholders and administrators of the Issuer[7], as well as by those persons who leave the company's administration before the public release of negotiations or facts initiated during the period of their administration, and this prohibition is extended for six months after their departure as administrators.

(vi) disclose in the company's webpage any material event and notify immediately the lead intermediary institution of the offer about the occurrence of the material event. This information shall also be simultaneously sent to the entities which administrate the markets in which the offered securities are admitted for trading; and

(vii) furnish any information requested by CVM.

The purpose of the new regulations is to simplify the procedure and reduce the costs of the public offers of securities distributed with restricted efforts and consequently to facilitate the access of the Issuer to the Brazilian securities market.

Article 2 of CVM Instruction 358/2002 defines "material events" as "any decisions by majority shareholders, general shareholders' meetings, or by officers of publicly-held companies, as well as any other acts or facts of a political-administrative, technical, business or financial nature related to the relevant business that may significantly influence: (i) the market price of the securities issued by the relevant corporation or backed on them; (ii) investors' decisions as to buy, sell, or preserve those securities; (iii) investors' decision as to exercise any rights inherent to titleholders of securities issued by the by the relevant corporation or backed on them"[8].

Only securities whose legal instruments list all the above-mentioned obligations of the Issuer may be traded on the Brazilian regulated markets. These obligations do not apply to: (a) Issuers of securities which cannot be negotiated in such regulated markets and (b) investment funds.

The purpose of the new regulations is to simplify the procedure and reduce the costs of the public offers of securities distributed with restricted efforts and consequently to facilitate the access of the Issuer to the Brazilian securities market. ❏

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1 According to the provisions of article 15 of Law nº 6.385, of December 7, 1976 (which governs the Brazilian securities market and creates CVM), the securities distribution system in Brazil comprises the following participants: I - financial institutions and other corporations engaged in the activity of distributing

securities issues: (a) as agents of the issuing corporation; or (b) for their own account, underwriting or purchasing the issue in order to place it on the market; II - corporations engaged in the activity of purchasing securities available on the market, in order to resell them for their own account; III - corporations and independent agents engaged in intermediation activities in the trading of securities, on Stock Exchanges or the Over-The-Counter (OTC) market; IV - Stock Exchanges; V - organized OTC markets; VI - commodities brokers, special operators and the commodities and futures exchanges; and VII - securities clearing and settlement entities.

2 This rule is contained in the head of article 19 of Law 6385/1976.

3 In the case of a fiduciary relationship (regime fiduciário) the transaction is not an obligation of the securitization company and it is essentially secured by credit rights. This type of instrument introduced concepts of trust ownership (or fiduciary ownership) for the asset (real estate or agribusiness) and trust title of credit rights originated by sale or rent of such asset. The property of the asset and/or title of credit rights are hold in the name of an independent trustee until the loan is repaid. It increases the ability of the lender to execute the loan in the event of borrower's default.

4 These norms of conduct are set forth in article 48 of CVM Instruction 400/2003, except for item III, which is not applied to a public offer distributed with restricted efforts and implies in presenting CVM research and public reports about the company and the operation it has developed.

5 Pursuant to article 21 of Law 6.385/1976, only the securities issued by a corporation registered with CVM can be traded on the Stock Exchange.

6 CVM Instruction 358/2002 regulates the disclosure and use of information about relevant acts or facts, the disclosure of information in the negotiation of securities of issuance of publicly-held companies by controlling shareholders, directors, members of the board of directors, of the fiscal board and of any agencies with technical and advising functions, according to the bylaws, as well as, in the event of the acquisitions of significant blocks of shares issued by publicly held companies, and the negotiation of publicly held companies' shares in the event of pending of non-disclosed relevant facts to the market. The duty of confidentiality is mentioned in article 8 and the negotiation prohibitions are described in articles 13 and 14 of CVM Instruction 358/2002.

7 The same veto applies to those who are aware of information concerning material events, knowing that it concerns information not yet revealed to the market, especially to those with whom they have commercial, professional or confidence relations with the company, such as independent auditors, securities analysts, advisors and partner institutions of the distribution system, who have the authority to verify the disclosure of information before negotiating with securities issued by the company or related to them.

8 Pursuant to the sole paragraph of article 2 of CVM Instruction 358/2002, material events may include, but are not limited to: (i) signature of agreements or contracts regarding the transfer of the control of the company, even if under conditional provisions; (ii) changes in the control of the company, including celebration, amendments, or cancellation of shareholder agreements; (iii) celebration, amendments, or cancellation of shareholder agreements in which the company takes part in or are intervenient, or if they have been registered in the appropriate book maintained by the corporation; (iv) admission or departure of shareholders maintaining contracts or operational collaboration regarding financial, technological or administrative issues with the company; (v) authorization for listing securities issued by the company in any domestic or foreign market; (vi) decision to go private or decision to promote the cancellation of the publicly-held company's register; (vii) incorporation, merger or spin-off involving the company itself or linked corporations; (viii) transformation or dissolution of the company; (ix) changes in the company's assets; (x) changes in accounting criteria; (xi) renegotiations of debts; (xii) approval of stock options plans; (xiii) changes of the rights and privileges of the securities issued by the company; (xiv) splits, reverse splits or the issue of share dividends; (xv) acquisition of shares for the purpose of increasing treasury stock or cancellation, and the selling of shares so acquired; (xvi) amount of profits or losses and the distribution of dividends; (xvii) celebration or termination of contracts, or failure to close a deal, when the expectation for such is of public knowledge; (xviii) a project's approval, alteration or abandonment, as well as a delay in its implementation; (xix) starting, retaking or suspending the manufacturing or commercialization of products or of services rendered; (xx) discoveries, changes or developments regarding technology or companies' resources; (xxi) modification of disclosed projections by the company; (xxii) reorganization arrangements, bankruptcy, or any lawsuit that alters the corporation's financial situation.

Chile Announces Economic Stimulus Package to Boost Domestic Demand

By Alejandro Rojas and Lorena Barrientos (Morales & Besa LTDA)

Summary

On January 5, 2009, Chile announced a USD 4 billion economic stimulus package to revamp the Chilean economy and minimize the impact of the global economic crisis on the Chilean economy. Among other measures, the package will cut taxes for businesses by USD 1.45 billion and provide government lending of up to USD 500 million for small and medium-sized enterprises (SMEs).

Analysis

On January 5, 2009, Chilean President Michelle Bachelet announced an economic stimulus package to foster economic growth and reduce the impact of the global economic crisis on the Chilean economy. The USD 4 billion stimulus package will seek to boost domestic demand and increase productive capacity for SMEs. The stimulus package accounts for 2.8 percent of Chile's total gross domestic product (GDP) and the government will finance the package entirely with savings, mainly drawn from cooper earnings.

As a part of the stimulus package, Chile will implement the following measures:

- A temporary suspension of Chile's stamp tax applicable to mortgage lending and commercial loans (without the suspension the stamp tax rate may rise up to 1.2 percent of the loan principal and often becomes an obstacle for SMEs to obtain credits). The temporary suspension would be in effect until December 31, 2009.
- A 15 percent reduction (7 percent for larger companies) in the monthly provisional income tax payments for SMEs.
- Financial assistance of up to USD 500 to provide further mortgage lending to home owners and credit lines to SMEs at preferential interest rates.[1]
- Government spending on health care and other benefits will remain the same. In addition, Chile will spend USD 400 million in public housing projects to foster home sales and create 60,000 new jobs.

Chilean Minister of Finance Andrés Velasco stated that the stimulus package will seek to revamp the economy by expanding credit, increasing domestic demand for goods and services and fostering job creation. Minister Velasco stated that the stimulus package will increase Chile's GDP in one percent in 2009, reaching to two or three percent. However, most analysts forecast that Chile's economy will grow one percent in 2009, while some others are skeptical of this forecast and predict a growth rate of 0 percent.

The USD 4 billion stimulus package will seek to boost domestic demand and increase productive capacity for SMEs.

Outlook

In contrast to other Latin American countries that are also implementing similar economic packages, Chile will finance its USD 4 billion stimulus package entirely with government savings. In 2008, Chile's total savings raised to USD 28 billion (mainly from copper earnings). In recent years, Chile opposed increased government spending despite booming global copper prices in 2008. Chile's copper earnings, however, will provide the country with enough financial cushion to address the current economic crisis without seeking additional financial support from other sources, such as international financial institutions. Despite Chile's solid economic position, Chilean economists have revised their 2009 growth forecasts to 1.5 percent from the 2.0 percent forecasted in December 2008. Rafael de la Fuente, senior Latin American economist at BNP Paribas in New York, stated that Chile's savings "will not avoid a slowdown, but will cushion a fall," praising Chile's strict surplus rule, that has allowed the country to accumulate substantial savings in the past decade.

In 2008, Chile managed to weather the global economic crisis, although the decrease in global demand for commodities has affected Chilean exports. Chile's exposure to commodities is relatively high because approximately 77.3 percent of Chile's exports are commodities and metals account for 54.4 percent. In December 2008, Chilean exports totaled USD 3.6 billion, a 24.4 percent decrease as compared to December 2007. Chile's Central Bank reported that Chile's trade surplus in 2008 totaled USD 10.16 billion, a 57 percent decrease as compared to 2007. The substantial decrease of Chilean exports is linked to the decrease of copper exports, in particular to

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China. Chilean copper exports totaled USD 1.98 billion in November 2008, a 31 percent decrease as compared to November 2007. The decrease is attributable to the fall in global copper prices in the second half of 2008, which decreased from USD 4.07 per pound in July 2008 to an average USD 1.3 per pound by December 2008. According to Chile's National Mining Association (SONAMI), an average reduction of one cent in the price of copper leads to a decrease of USD 120 million per annum of copper exports. SONAMI reported that several mining companies are already operating with losses.

The global economic crisis has also affected other sectors of the Chilean economy, such as real estate and the automotive sector. New car sales decreased by 32 percent in November 2008, as compared to November 2007, and analysts forecast lower sales in 2009. Overall, analysts and industry groups welcomed the stimulus package. Analysts, however, remain skeptical that the package will help to increase Chile's economic growth rate, while others criticize the lack of inclusion of considerable tax breaks, such as a reduction in Chile's sales tax or value added tax (VAT). ❑

1 On December 4, 2008, the Chilean Chamber of Deputies approved a bill that authorizes a USD 500 million capitalization of Chile's Banco del Estado de Chile (BEC), a private state-owned bank, which would allow the BEC to increase loans to SMEs in USD 1 billion. The new law would also authorize a governmental contribution of more than USD 130 million to the Small Enterprises Security Fund, managed by Chile's Corporación de Fomento de la Producción (CORFO), aimed to guarantee a portion of the loans that financial institutions grant to SMEs. The Chilean Senate is considering the bill, which will become law once the Senate approves it.

MEXICO

U.S. - Mexico Relations: A Commentary

By Sidney Weintraub (Center for Strategic and International Studies)

This commentary returns to the theme discussed earlier because the situation in Mexico has deteriorated during the past several months largely because of contagion from the U.S. financial and credit meltdown. Mexico's economy is projected to decline in 2009, the violence spawned by the drug trade is unacceptable, and the country has become the kidnapping capital of the world. This is happening in a populous country with about 110 million people that shares a 2,000-mile border with the United States-and which will always be next door. Mexico's domestic developments are an integral part of U.S. foreign and domestic policy-just as U.S. domestic actions have immediate reverberations in Mexico.

Most of Mexico's problems are made in Mexico. The country's relatively low growth in gross domestic product, about 2.5 percent on average each year during the past 25 plus years, means that its economy has not converged with that of the United States-rather, the spread between the two economies has grown over this time. Mexico's relatively low growth stems from the lack of complete (that is, some action has been taken on many of the following issues) corrective action on vital structural matters, such as low tax collections, inadequate investment in energy, an inferior educational system at primary and secondary levels, a labor law that encourages employers to shun hiring full-time workers, the acceptance of public and private monopolies-and, with all of this, the existence of bribery in the social system. The pay of workers in manufacturing, an activity in which wages are relatively high, is about 15 percent of wages in the United States. It is no wonder that enterprising young Mexicans seek to escape to the United States, with or without papers. About 10 percent of persons born in Mexico now live in the United States. These kinship connections augment the effects of what takes place in either country on the other.

But not all of Mexico's problems originate in Mexico. The violence that accompanies the shipment and sales of narcotics from and through Mexico to the United States stems primarily from U.S. antinarcotics policies. U.S. consumption of such drugs as methamphetamines, opium, marijuana (which originate in Mexico), and cocaine (for which Mexico is the main shipment route from Colombia) provide Mexican drug cartels with what has been estimated to be between $15 billion and $35 billion a year. The drug cartels have enough money to bribe underpaid Mexican officials-often threatening to kill officials if they refuse to enter into clandestine employment with the cartels. What the cartels earn from sales in the United States permits them to buy the sophisticated weapons they need-largely openly in the United States and then smuggled into Mexico. This permits the drug warriors to outgun the police and military in particular encounters. The wars between competing cartels are stimulated by the desire to control the bulk of

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the drug sales in the United States. The U.S. government and Congress often berate Mexico for not interdicting drug shipments that cross the border into the United States, but the U.S. authorities are no more successful at interdiction after the narcotics enter into U.S. territory.

The U.S. government makes much of the fact that legislation was enacted in 2007 to provide some $400 million to Mexico in the current fiscal year for equipment to strengthen Mexico's anti-narcotic forces in their battles with the drug lords-but the U.S. publicity does not make clear how modest this amount is compared with the resources (about ten times more a year) Mexico itself must provide to stem its domestic drug violence. The passage of this legislation by the U.S. Congress-the Mérida Initiative, named after the place where the Mexican president asked for some anti-narcotics cooperation from President Bush-was by no means gracious; much of the congressional debate focused not on the killings in Mexico but on U.S. verification that the human rights of the drug dealers were being protected. Nevertheless, the legislation was eventually passed and will help in Mexico's antinarcotics efforts.

Some 5,300 people were killed in Mexico in 2008 stemming from the drug trade. To put this number in perspective, it is more than all the U.S. deaths in the war in Iraq. Most of the persons murdered were from competing drug cartels, but also included police and military seeking to stanch the drug trafficking, officials appointed to run Mexican anti-drug programs, journalists who dare to report honestly on narcotics issues, and innocent bystanders. Many of the murder victims are decapitated and then thrown into the streets for all to see. This atmosphere of violence is aggravated by what is believed to be hundreds of kidnappings each month; the official kidnapping figure is around 70 a month because most families prefer to pay the ransom without police involvement.

The effects of the violence in major Mexican cities, and particularly in large border cities such as Tijuana and Ciudad Juárez, are devastating. Foreign investors are reluctant to send key personnel to Mexico-and foreign investment in Mexico is declining-and many foreign tourists are choosing non-Mexican destinations. There can be no effective democracy if the main concern of the population is personal safety; democracy demands trust and this cannot exist side-by-side with rampant violence. When a young man was kidnapped in Mexico City and then murdered after ransom was paid, the cry of hundreds of thousands of demonstrators was that if the current government cannot provide safety, its leaders should resign so that others up to doing the job can replace them. There is considerable concern in U.S. border cities such as El Paso, Texas, and near-border locations such as San Diego, California, because the violence cannot be contained in Mexico.

It would be useful if President Obama states early in his administration that U.S. anti-narcotics activities are not working as intended. Alleviating Mexico's drug-related violence requires changes in U.S. policy. Mexico is already doing about as much as it can-reorganizing police forces, using the military as the primary anti-drug agency, choosing the times and sites for battles with the cartels' own military forces to avoid being outmanned and outgunned, and improving official intelligence on the drug cartels. The U.S. "war on drugs" is much like other wars; bystanders are killed, even as the war itself is not being won. An honest debate is needed on potential changes in U.S. drug policy: less imprisonment of young users; stopping the shipment of arms to buyers from Mexican drug cartels; cutting off the outsized earnings of the cartels by decriminalizing the sale and use of some drugs (such as marijuana) or all drugs, especially cocaine; official provision of drugs to addicts (as Switzerland does for its heroin addicts); more education for the U.S. public on drug addiction; more funds for drug treatment. Instead, Michael Chertoff, Secretary of the U.S. Department of Homeland Security, has reportedly indicated that he favors a "surge" of personnel, including the military, and equipment, if needed to prevent violence in Mexico from crossing over into the United States. This would do nothing to reduce drug-related violence in Mexico.

The emphasis in this discussion has been on U.S. anti-drug policy and its effects on Mexico because this policy is hard to revise. Much antinarcotic responsibility in Mexico lies with the separate states rather than the central government. Public opinion polls indicate that there is little sentiment in the U.S. public for decriminalizing drug use, although this position could change if the facts are made known from public debate-about the high level of imprisonment in the United States for drug offences as compared with just about all other countries in the world (indeed, more than all of Western Europe combined); and about how the U.S. war on drugs is destabilizing Mexico.

Two other issues in U.S.-Mexico relations could usefully be articulated reasonably early in President Obama's tenure. These are that the U.S. market will remain open to Mexico's exports; and that undocumented immigrants from Mexico (and other locations) will be granted legal status if they can demonstrate that they have been in the United States for a reasonable amount of time and steps are taken to prevent another buildup of new cohorts of undocumented immigrants.

The U.S. government position is that U.S.-Mexican relations are good. Nevertheless, there are deep differences between the two countries. These deal with important issues such as narcotics, migration, U.S. trade policy, Mexico's unreliability as a future oil supplier, the fence on the border, and the inability of Mexican trucks that meet U.S. safety standards to deliver cargo directly to destinations in the United States (except under a special program that the U.S. Congress opposes). ❏

New Protocol to the Mexico/Netherlands Tax Treaty

By Fred Barrett and John Salerno (PricewaterhouseCoopers LLP)

On December 11, 2008, the Mexican Ministry of Finance and the Dutch Ambassador to Mexico signed a new protocol to the Mexico / Netherlands Tax Treaty, which includes relevant modifications to the current Tax Treaty between both countries.

The new protocol to the Tax Treaty may be advantageous for US MNCs that hold Mexican subsidiaries through a Dutch holding company. In this regard, the protocol includes a lower level of income tax on capital gains realized on a sale of shares, and greater certainty in connection with reorganization transactions under the protocol's reorganization definition. The protocol may also be beneficial for US MNCs that wish to structure loans to Mexican subsidiaries through the Netherlands.

The new protocol will enter into force thirty days after the constitutional requirements in both countries have been fulfilled, but its application will be effective the following year in which the new protocol enters into force. Thus it will likely take effect as of January 1, 2010.

The following is a summary of some of the more salient aspects of the new protocol:

Flat Tax

The Mexican Flat Tax is covered by the new protocol.

Dual Residence

When a company maintains dual residence (i.e., is resident for tax purposes in both States), the place of effective management or the country of tax residence should be resolved by a mutual agreement procedure between the States. During the period in which the residence issue is being resolved, the entity in question would not be entitled to apply the tax treaty, except for the "non-discrimination" and "mutual agreement procedure" provisions. There is a definition of "place of effective management," which is considered to be the place where the most important decisions are made.

Limitation of Benefits - Special Regime

Entities or other persons, which are fully or partially exempt from taxes due to the application of a "special regime" in accordance with the local law or administrative practice of any of the Contracting States, should not be entitled to the benefits of the tax treaty.

The definition of a "special regime" will be determined by mutual agreement between the competent authorities of both countries.

The new protocol to the Tax Treaty may be advantageous for US MNCs that hold Mexican subsidiaries through a Dutch holding company.

Interest

In general terms, the new protocol provides for a 10% income tax withholding rate on interest paid to the beneficial owner that is resident of the other State. A 5% income tax withholding rate would apply in the case of interest paid to banks or financial institutions, or on bonds regularly traded on a recognized stock exchange.

The definition of interest is comprehensive ("long definition"), including commissions on granting and guaranteeing credits, factoring payments, income derived from financial instruments relating to an underlying debt, transfer of credits, etc.

Capital Gains

Capital gains from the sale of shares may be taxed by a Contracting State regardless of the ownership percentage in the capital stock of a company, but the tax will not exceed 10% of the gain recognized. In this regard, the exception to achieve a 0% income tax rate on capital gains on the disposal of Mexican shares, through a structure where a Dutch company owns up to 25% of the shares in the capital stock of the Mexican entity is no longer available with the introduction of the new protocol.

The term "reorganization" is clarified to allow application of the treaty-provided reorganization exemption on capital gains to the transfer of shares.

Sales of publicly-traded shares may be taxed, if A) a seller owns 10% or more than 10% of the shares in the capital stock of the issuer, and the seller transfers 10% or more of the shares of the issuer in one or several consecutive transactions within a 24 month period, or B) the seller does not have the possibility of accepting different competitive bids.

Exchange of Information

In order to avoid evasion and fiscal fraud, there will be more cooperation to exchange information. This will be based on domestic law, and includes the exchange of financial and banking information. ❑

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Global Financial Crisis: Workouts and Other Alternatives in Mexico

By Guillermo Uribe Lara and Alejandro Landa Thierry (Thompson & Knight Abogados, S.C.)

It has been a long time since the world has faced a global financial crisis of this magnitude. The global integration of the financial systems has evidenced that what started as a problem focused on the mortgage sector of the United States, has been gradually generalized as a crisis of investor confidence and as an international contagion.¡

The global economy faces an important process of reducing its leverage. Consequently, the international financial arena has been characterized by a recessive environment in the United States and other industrialized economies and a slowdown in the rest of the world, including Mexico.

Challenges to Come

The Mexican economy does not have immunity from the global financial crisis and it has already impacted several elements of the economy. For instance, due to the small availability of credit in the international markets and the "fly to quality" of the investments, Mexican companies have experienced important liquidity issues.

In the second half of 2008, due to the change in the exchange rate that the Mexican Peso experienced, several companies had important losses in terms of the derivatives they acquired. Companies such as *Comercial Mexicana*, one of the most important retail stores in Mexico, *Cemex*, and *Gruma* face important payments to their derivative counterparties that will have to be covered in a difficult economic environment.

Furthermore, several infrastructure projects have been postponed until market conditions allow their release. Due to the current local market conditions and a lack of liquidity in the international markets, mega projects are considered unfeasible at the moment.

Government's Response

As a response to the economic challenges ahead, the Mexican government has adopted, directly or through its development banks[1], several measures.

As an effort to support the construction of infrastructure in Mexico and to face the difficulties of funding, in the first quarter of 2008 the Mexican government created the National Infrastructure Fund (*Fondo Nacional de Infraestructura*) known as FONADIN.

The Mexican economy does not have immunity from the global financial crisis and it has already impacted several elements of the economy.

FONADIN concentrates the activities, assets, and liabilities of the Trust for the Support of the Toll-Roads Rescue (*Fideicomiso de Apoyo para el Rescate de Autopistas Concesionadas*) know as FARAC and the Investment Fund for Infrastructure (*Fondo de Inversion en Infraestructura*) known as FINFRA. The initial amount of FONADIN's funds was approximately $40,000 million pesos and it was estimated that in the following five years after its creation it would convert to about $270,000 million pesos.

In general terms, the purposes of FONADIN are to: (i) promote the participation of the public, private, and social sectors in the development of infrastructure and public services; (ii) support the development of infrastructure public works in charge of the Federal Public Administration; (iii) participate in the design, construction, financing, operation, and transference of infrastructure and facilitate access to the users of such; (iv) participate in the evaluation, structuring, and execution of infrastructure projects; (v) acquire, manage and assign rights and obligations set forth in concessions and permits; (vi) dispose of the assets of its estate; and (vii) execute, acquire, and manage financial instruments associated with infrastructure projects.

Due to the purposes and amounts assigned to FONADIN, it will play an important role in the viability of infrastructure projects in Mexico. Innovative and creative funding schemes along with possible guaranty structures are some of the activities that FONADIN will be engaging in.

In the corporate arena, the development banks have been very active through their securities guaranty programs and financings. In times when liquidity has become an issue, companies such as *Cemex*, *Coppel*, and *Soriana* have obtained support from NAFIN by adhering to NAFIN's securities guaranty program. On the other hand, through

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BANCOMEXT, the Mexican government has granted, in record time, loans to companies whose liquidity has been jeopardized due to the exchange rate, derivatives contracted, and the lack of sources of funding.

Options of Mexican Companies

The Mexican government has been very active in trying to assist Mexican companies in facing the effects of the global financial crisis. Understanding the industry and the type of challenge each company may face is the first step in deciding and obtaining the best support.

For instance, NAFIN and BANCOMEXT have been providing liquidity to the commercial paper market and have granted guaranties of up to 50% of the net balance of the debt issued. When dealing with a construction company or the construction industry, without a doubt, BANOBRAS and FONADIN are the right doors to knock on. Finally, financial institutions focused on mortgages and housing developments might receive important support from the SHF since it recently closed a credit line with Banco Interamericano de Desarrollo (Inter-American Development Bank) for an amount of US$2,5000 million.

Sailing in troubled waters requires full attention. While a workout may be feasible in some circumstances, a bankruptcy procedure may arise in others.

In Mexico, the bankruptcy procedure is called *concurso mercantil*. The *concurso mercantil* is a procedure that consists of two stages: (i) the conciliation and (ii) the bankruptcy. While the purpose of the conciliation is to reach the preservation of the company by means of an agreement with the creditors, the purpose of the bankruptcy is the sale of the company in order to pay the recognized creditors.

Depending on the circumstances, the first step when a company is in financial trouble is a workout outside the courts. Then, if no agreement is reached or if it is impossible to reach an agreement because there are too many creditors, the *concurso mercantil* is followed.

Conclusion

It seems that 2009 will likely be a global recession year. Due to the financial and commercial integrations Mexico has with the U.S. economy, weakening of the Mexican economy is anticipated.

Mexican companies will face important challenges in terms of their income and leverage. Therefore the design and implementation of creative legal and financial solutions will represent an important role in the success of Mexican companies. Without a doubt, knocking on the right doors might make the difference between staying in business and shutting down. ❑

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1 Nacional Financiera, S.N.C. (NAFIN), Banco Nacional de Comercio Exterior, S.N.C. (BANCOMEXT), Banco Nacional de Obras, S.N.C. (BANOBRAS) and Sociedad Hipotecaria Federal, S.N.C. (SHF).

Incentives for the Petrochemical Industry in Venezuela

By Rafael Enrique Tobía (Rodríguez & Mendoza)

In the last 10 years Venezuela has undergone significant political and economic change. The change has been driven to a significant extent by the local government's recognized need to make a greater and more efficient use of the income generated by the hydrocarbon industry. The government's efforts have been directed to promote and diversify the production of goods related to or derived from hydrocarbons (natural gas for industrial and household use, agrochemicals, plastics, resins, polyethylene, nylon, chlorine, soda ash for industrial processes, all of which are included among the inputs for the manufacturing and fertilizer industry), and thereby to cover a growing demand in the domestic market, reduce dependence on imports and, in case of surplus, export and ensure the flow and entry of foreign currency to the country.

2006-2012 Petrochemical Development Strategic Plan

In line with this purpose, the Venezuelan government has outlined a so-called "2006-2012 Petrochemical Development Strategic Plan" to "increase the production capacity of Petroquímica de Venezuela, S.A. and its affiliates and Mixed Enterprises from 11.5 to 32 million metric ton per year. It seeks increase sales by ten times, passing from the current yearly income of US$ 1,2 billion to US$ 12 billion per year, in six years".[1]

As part of the Strategic Plan, it has also proposed to construct and place in operation two new Petrochemical Complexes (Paraguaná and Güiria), along with the consolidation and streamlining of "Jose" and "Moron" Petrochemical Complexes and the reactivation of "El Tablazo" Petrochemical Complex. It is estimated that this will require an initial and joint investment from the private and government sectors of about 10 billion dollars.[2] Venezuela thus seeks to follow the trend worldwide set by countries that have considerable reserves of crude oil, and which involves investing in the development of their petrochemical industry in order to overcome the adverse effects that crude oil price volatility and market instability have on their economies. An attractive and important edge in such development is clearly the use of their low cost raw material (particularly, natural gas). This use can generate, in certain intermediate sectors of the petrochemical industry, and according to the National Council for Investment Promotion (CONAPRI), up to 10 times greater value than that generated by the oil extraction industry.

The national government is nevertheless aware that in light of the economic and technological possibilities existing in the country, a sustainable development of the petrochemical industry will only be feasible if it counts on the investment and support of the local and/or foreign private sector, and provides the incentives and legal safety required.

Venezuela thus seeks to follow the trend worldwide set by countries that have considerable reserves of crude oil, and which involves investing in the development of their petrochemical industry in order to overcome the adverse effects that crude oil price volatility and market instability have on their economies.

Accordingly, as a first step in the area of tax incentives, the Partial Reform Act for the Law on Promotion of Development of Petrochemical, Carbochemical and Similar Activities has been publishes on June 28, 2006 in the Official Gazette No. 38.488, has exempted the tax on dividends (taxed at a proportional rate of 34% in Venezuela) earned by the mixed enterprises that invest jointly with the state-owned company, Petroquímica de Venezuela, S.A. (PEQUIVEN), in the petrochemical sector. In fact, Article 10 of said Law has provided that: "The net income obtained by Petroquímica de Venezuela, S.A. (PEQUIVEN), and the dividends from its affiliated or mixed companies engaged in petrochemical, carbochemical, or similar activities, are exempt from Income Tax (ISRL) payment." (Emphasis ours). In other words, the Law is intended to encourage the formation of strategic alliances with the public sector, through the creation of mixed enterprises comprised of both the public as well as the private sector, in order to form an organization that is competitive and profitable at the national and international level and characterized by high technology

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standards. In turn, the Republic has granted a Dividend Tax exemption.

Nevertheless, in order to achieve the projected growth planned in the Petrochemical Development Strategic Plan 2006-2012 for the basic, intermediate and final petrochemical industry, the State needs to offer greater incentives that do not require an association between the State and private investors, that is, the implementation of mixed enterprises. Such approach will stimulate private free initiative in the sector, and will ensure the flexibility and high competitiveness demanded by the petrochemical business.

Towards a New Legal Framework

Ley Orgánica para el Desarrollo de Actividades Petroquímicas (LODAP). Tax Incentives.

In this line of thought, the terms of a Bill on the Development of Petrochemical Activities (Proyecto de Ley Orgánica para el Desarrollo de las Actividades Petroquímicas (LODAP)) are being discussed in the National Assembly (Congress). The purpose of this bill is not only to formulate special legislation for the petrochemical sector of the country but also to establish a number of fiscal benefits and regulations aimed at procuring the legal stability required by local and foreign investors.

From the regulatory framework proposed under the LODAP bill we may highlight the establishment of an important set of tax benefits or incentives in the area of Income Tax, Dividend Tax, and Value Added Tax. The effectiveness of such benefits during the initiation and progressive execution of the projects in the sector could become additionally guaranteed by the investment protection technique of entering into "legal stability agreements."

In fact, the Bill contemplates the following tax benefits: (i) Income tax exemption for the first 4 years from commencement of operations. Today, in Venezuela, the petrochemical industry net income is subject to Income Tax at a progressive rate of up to 34%; (ii) Income tax exoneration on the capital growth arising from royalties, technical assistance and technology services used in developing petrochemical projects; (iii) Income tax exoneration on the profits made by financial institutions, whether Venezuelan or organized abroad, from loans and credits granted and invested in petrochemical projects. In this regard, we note that this legal provision would seek to exonerate financial institutions from paying the proportional tax on interest obtained from loans, which is equal to 4.95% of the total of such interest payment; (iv) Income tax exoneration on dividends paid by corporations that have obtained those profits in the execution of petrochemical industrial projects; (v) Recovery of VAT borne by corporations that execute industrial projects in the petrochemical sector, during the "pre-operational" phase. This benefit is designed to neutralize the economic effects that would represent for that industry the payment of VAT in the term elapsing between the commencement of the execution of the industrial project and the entering into the activities for the sale or export of the goods produced; (vi) VAT exoneration in operations involving the purchase-sale of liquid or gas hydrocarbons to be used in the production of the characteristic goods of the basic, intermediate and final petrochemical industry, which contributes to a decrease in production costs and favors competitive and profitable pricing.

The effectiveness of such benefits during the initiation and progressive execution of the projects in the sector could become additionally guaranteed by the investment protection technique of entering into "legal stability agreements."

Legal Stability of Tax Benefits

Additionally, the LODAP establishes the possibility for the National Government to subscribe to Stabilization Agreements, provided that the authorization of the National Assembly (Congress) has been granted. These Stabilization Agreements are directed to maintain the tax benefits referred above, during the execution of the projects. In addition to this, according to the LODAP, the National Government is authorized to enter into agreements with the purpose of granting other kind of benefits such as, for instance, a special and flexible regime regarding the exchange control system currently in force, in order to regulate the purchase and sale of the foreign currency demanded by the development of those projects.

The purpose of those Stabilization Agreements in the petrochemical area, is to guarantee the investor stability in the different laws applicable to it's petrochemical business during the execution of the industrial project, in order to allow the return of the investment and its revenues based on the conditions and variables that were originally considered for the structuring of the industrial project.

In any event, the LODAP project is still being discussed by the National Assembly (Congress) and it has received comment from the primal associated sectors. In particular, the restricted participation of the private sector by the incorporation of mixed enterprises, has been carefully reviewed, along with the tendency to limit the enjoyment of the tax benefits to the compliance of the investor and its project with goals related to the satisfaction

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of the internal demand, which might lead to discourage the activities directed to the exportation of products that, in the end, provides unquestionable benefits for the petrochemical industry and for the national treasury.

It is clear that in Venezuela the petrochemical sector has room for growth and that there is an excellent opportunity for exploiting its great potential, especially based on its principal raw material: natural gas. Venezuela has the second largest reserve of natural gas in the region: approximately 152 trillion cubic feet, according to authorized national reports[3]. In this regard, it is very important to point out that in October, 2008 the national government entered into agreements with foreign investors for the creation of mixed enterprises to explore and exploit natural gas in the Deltana Shelf and in the Gulf of Paria (this latter, with approximate reserves of 14.3 trillion cubic feet), as well as for the construction of liquefaction trains, thus opening investment opportunities in the petrochemical sector. In conclusion, firms seeking to do business in Venezuela should examine the possibility of legally protected strategic alliances with the public or private sector, so as to make use of the advantage of natural gas and the petrochemical industry. ❑

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1 GABALDÓN, Reynaldo; GUEVARA Simón. "La Industria Química y Petroquímica en Venezuela", published in: Revista Petróleo YV. Nº 36. 2008.

2 Source: National Council of Investment Promotion (Consejo Nacional de Promoción de Inversiones (CONAPRI))

3 "La Energía en cifras 2006-2007" issued by the Energy and Environment Center of Instituto de Estudios Superiores de Adminstración (IESA).