

NEWS FROM THE  
BRAZILIAN CHAMBER OF COMMERCE  
IN GREAT BRITAIN

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# BRAZIL BUSINESS BRIEF

SEPTEMBER 2013

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NEWS FROM THE BRAZILIAN CHAMBER  
OF COMMERCE IN GREAT BRITAIN



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# EDITOR'S LETTER



LENA BERALDO & ALEX THOMAS

Dear Members,

Welcome to the latest Brazilian Business Briefing.

This edition provides an overview of Brazil's current economic situation in the form of an interview with Paulo Skaf, who works at the heart of Brazil's economic powerhouse as president of the São Paulo Federation of Industries. The focus of all our other articles is more specific, with the subjects ranging from the pre-salt oil and gas bidding round to the market for energy commodity derivatives in Brazil.

Allow us to remind you that are always keen to hear your thoughts and suggestions for articles and events: you can contact us via [brazilianchamber.org.uk/contact-us](http://brazilianchamber.org.uk/contact-us)

Best wishes,

Lena & Alex 

EDITOR'S LETTER

# ARTICLES

## WINNING IN GROWTH MARKETS

BY PRASHANT BHARADWAJ HEAD, GROWTH MARKETS STRATEGY PROGRAMME, DELOITTE LLP  
AND LEO FERREIRA LEAD PARTNER, BRAZIL SERVICES GROUP, DELOITTE LLP

The growth of the new middle classes outside the western economies could well be the most prominent economic trend in the decades to come. In Brazil, for example, the middle class now accounts for nearly 52% of the population<sup>1</sup>, which is a critical factor when analysing the country's economic growth, development expectations and political stability.

With the economic expansion of Brazil, India and China, as well as the other fast-growing countries, the spending power of the world's new middle classes has surged, as have their demands for world-class infrastructure, better healthcare, and more sophisticated goods and services. These economies tend to be called growth markets, and Brazil is a leading example. The popular protests which have been taking place in several Brazilian cities are a powerful example of the changing aspirations of the new middle class.

The scale and pace of growth, and the inherent unpredictability associated with the growth markets, is creating the need for complex solutions which require significant knowledge and technology-intensive capabili-



ties. It is important, therefore, that companies in mature markets such as the UK recognise the need to connect with the changing aspirations of the new middle classes. This issue is even more critical given the lack of growth which British firms face in their traditional markets.

While the mature economies' knowledge-intensive companies have some potential to meet the demand created by the new middle class, so far they have not been particularly successful at capitalising on this opportunity. The UK illustrates the failure of mature economies to take advantage of their competitive edge. Recognised as a

leading knowledge economy, the UK's knowledge-intensive companies have particularly strong positions in sectors such as business services and professional services, education, health services, medical equipment and pharmaceuticals. Indeed, knowledge-intensive industries make up almost 40% of British GDP, as compared with the global average of 30%. The OECD ranks the UK fourth in the world for its knowledge-intensive capabilities (relative to GDP), significantly ahead of the growth markets' average<sup>2</sup>.

### The UK trade paradox

UK companies are punching below

their weight in their trade with Brazil, however. Most of the UK's exports and foreign direct investment currently go to western markets. While the UK's share of global exports in 2011 was 3.9%, its share of exports to growth markets was only 1.9%<sup>3</sup>. In fact, the UK was 14th in the ranking of exporters to Brazil, securing less than 2% of the Brazilian import market<sup>4</sup>. It is true that over the last few years the British government has made efforts to encourage the growth of commercial relations with Brazil, but the number of UK companies operating in Brazil is still relatively small and is made up mostly of big companies such as BG Group plc and JCB.

### Explaining the trade paradox

We believe this trade paradox can be attributed to a lack of ambition, a gap in ground-level capabilities, and a limited understanding of the idiosyncrasies of the Brazilian market.

There are, however, some outstanding examples of UK success. Our analysis has shown that the companies which have been successful in growth markets tend to share a common characteristic – a purposeful approach to building and maintaining what we call 'local ecosystems'.

Shaping these ecosystems has helped some of the UK's most successful companies in the knowledge and technology sector to overcome the difficulties of expanding into these markets, mitigating risk while bridging cultural differences, and managing geographical, logistical and political complexities. We refer to them as 'knowledge champions'.

### Developing collaborative ecosystems for success

What do we mean by ecosystems? An ecosystem is a network of organizations and individuals that co-develop their capabilities and roles, and align their investments, so as to create additional value and/or to improve efficiency. A business ecosystem typically consists of a dynamic combination of innovators, allies, partners, influencers and complements. Critically, successful participants have moved away from an aggressive

edge champions shows that ecosystems work best where knowledge is a key resource which tends to be dispersed among different organisations around the globe, and where there is considerable uncertainty – which in turn means companies have to be flexible about how they create value. They need to engage a diverse group of stakeholders which provide different assets and capabilities.

The ecosystem model allows businesses to focus on their core operations, to cope with rising investment demands, and to adjust to changing situations. While typically facilitating a global delivery model, it also allows companies to manage economies of both scale and scope. But in order to make the ecosystem model work, companies need to change their mind-sets, promoting a behaviour and culture of collaboration throughout their organizations, and casting off old competitive attitudes.

Generally speaking, successful ecosystems benefit all parties – not only UK companies seeking to expand but also Brazilian collaborators seeking to partner with external knowledge champions to better integrate their local expertise in order to significantly expand their opportunities. ●

# ARTICLES

## NATURAL GAS IN BRAZIL: CHALLENGES, OPPORTUNITIES AND THE ROLE OF SHALE GAS

BY IEDA GOMES DIRECTOR AT ENERGIX STRATEGY LTD  
AND MARCIO BALTHAZAR DA SILVEIRA SENIOR PARTNER AT NATGAS ECONOMICS

**B**razil's energy mix is one of the greenest in the world, with biomass and hydroelectricity together accounting for 42.4% of the country's energy supply in 2012, compared the global average of 13.2%. Natural gas provides 7.2% of Brazil's final energy consumption, following remarkable growth during the early 2000's when the 3,000-km Bolivia-Brazil pipeline was commissioned, supplying an extra billion cubic metres (m<sup>3</sup>) per annum (Bcma).

Brazil currently consumes nearly 76 million m<sup>3</sup> per day of natural gas, 60% of which is produced domestically; the rest is imported from Bolivia or comes in the form of Liquefied Natural Gas (LNG). Brazil's annual per capita consumption is 151 m<sup>3</sup>, whereas China consumes 106 m<sup>3</sup> and India 45 m<sup>3</sup> – but this is still quite low when compared to the United Kingdom's 1,238 m<sup>3</sup>. In absolute terms Brazil consumes only 29.9 billion Bcma compared to 78.3 Bcma in the UK and 56 Bcma in India.

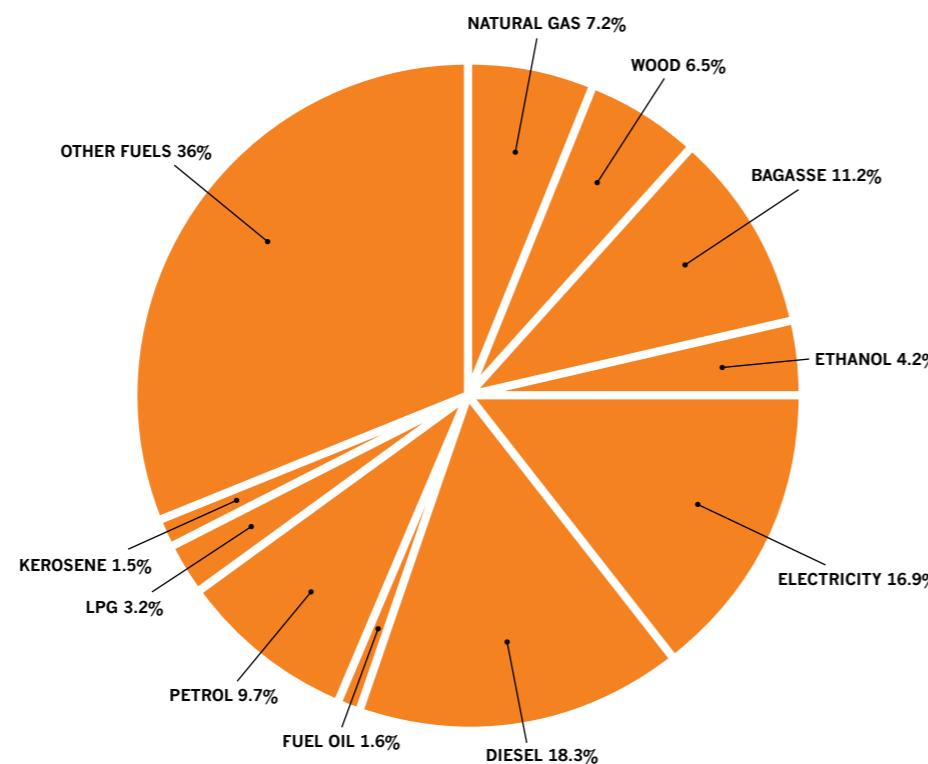
Brazil's domestic gas production is dominated by Petrobras, which also owns three LNG importing terminals and 9,244 km of gas pipelines. Gas distribution to consumers is regulated

by the federal states. São Paulo and Rio de Janeiro have private-owned gas distribution companies while all the other 25 states have a tripartite model: state government, Petrobras and a private investor.

When Petrobras and its partners announced the huge pre-salt discoveries there was an implicit assumption

that in addition to becoming an oil exporter Brazil would also be producing large volumes of associated gas, potentially increasing total domestic production to 200 million m<sup>3</sup> per day by 2020. That figure was subsequently revised downwards but the latest forecasts still point to a remarkable growth in domestic gas supply by

### BRAZIL: FINAL ENERGY CONSUMPTION 2012



2020. The National Petroleum Agency (ANP) is very optimistic about the upcoming auction in October for the Libra area in the Santos Basin and has announced that it may contain reserves of 8-12 billion barrels of oil equivalent, raising the prospect of Brazil doubling its oil production by 2020. The Santos Basin alone will have five production areas – one in the pre-salt and four in the post-salt. Petrobras' investment plan for 2013-

2017 totals US\$ 236 billion in 947 upstream and downstream projects. Private producers are predicted to invest another US\$ 100 billion.

There is huge demand for equipment and materials, support services and skilled labour, including pipelines, offshore support vessels, optical fibre cables, valves, compressors, and even the construction of new buildings. Petrobras' Santos business unit will require 2,800 new employees by

**THERE IS HUGE DEMAND FOR EQUIPMENT AND MATERIALS, SUPPORT SERVICES AND SKILLED LABOUR, INCLUDING PIPELINES, OFFSHORE SUPPORT VESSELS, OPTICAL FIBRE CABLES, VALVES, COMPRESSORS, AND EVEN THE CONSTRUCTION OF NEW BUILDINGS**

2020. Indeed, the city of Santos is poised to become another oil and gas mecca over the next 7-10 years.

Besides the pre- and post-salt prospects there are also very interesting possibilities as regards shale gas. ANP is launching an exploration bid round for onshore gas in November this year. According to ANP's estimates Brazil may have 15 trillion m<sup>3</sup> of potential shale gas resources, spread over five basins: Reconcavo, Parecis, Parnaiba, Parana and Sao Francisco. This is nearly 30 times Brazil's proven gas reserves. Or, to put it another way, if only 5% of that gas were recoverable, it would still more than double Brazil's proven natural gas reserves.

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The challenge for Brazil is the lack of gas transportation infrastructure around the shale basins and the shortage of drilling equipment and field development technology. In the heyday of shale gas in the US there were 1,600 drilling rigs in operation; Brazil will need to rise to this challenge. This suggests that companies exploring for shale gas in Brazil should partner with companies experienced in shale gas in the US.

Due to the lack of transportation infrastructure the alternative for producers wishing to monetise non-conventional gas is to develop power plants and gas-intensive industries close to the production site. In parallel Brazil will also need to answer environmental questions about the process of fracturing the shale rocks to extract natural gas ('fracking'). In 2012 the International Energy Agency proposed a set of 'Golden Rules' to address environmental concerns associated with the exploration of unconventional gas.

Besides the huge challenge in the exploration and production (E&P) segment, private oil and gas producers (mainly gas) also face other kinds of obstacles, both with regard to the regulatory framework and the need for

## THE RISKS ALONG THE VALUE CHAIN ARE PROPORTIONAL TO THE SIZE OF THE RELATED OPPORTUNITIES.

additional transportation and gas-processing capacity.

As in the upstream segment, the downstream segment will also require huge investments from private oil and non-oil companies in order to overcome infrastructure bottlenecks. And the risks along the value chain are proportional to the size of the related opportunities. In addition to the vast array of investment opportunities in upstream gas including pre-salt and shale resources there will be opportunities for investors to work with independent gas producers to deliver gas to markets.

And opportunities may arise in the following areas: shale gas seismic, drilling, fracking and water recycling; deepwater gas treatment, transfer and transportation infrastructure; natural-gas processing, local gas distribution grid expansion; natural-gas power generation; LNG niche import and export opportunities; gas-fired power

plants and gas equipment.

If ANP's optimistic view proves to be well-founded, Brazil may reverse the current situation and become a gas exporter, in which case it will also require technology and investment in LNG liquefaction facilities. In fact, given Brazil's territorial dimensions, it may be necessary to develop out-of-the-box monetisation solutions such as small LNG terminals/cabotage and also LNG trucking.

In addition to these opportunities, let's not forget the need for qualified human resources, certification, risk management and environmental services. ●

# THE 1<sup>ST</sup> PRE-SALT OIL AND GAS BIDDING ROUND IN BRAZIL

BY VERA H DE MORAES DANTAS  
PARTNER AT NORONHA ADVOGADOS, LONDON

In October, the Brazilian National Agency of Petroleum, Natural Gas and Biofuels (ANP) will be holding the first bidding round for the exploration and production of oil and natural gas in the pre-salt area. It will be the first time Brazil has ever held an oil and gas bidding round under the production-sharing agreement (PSA) regime introduced by Law 12,351 on December 22<sup>nd</sup> 2010. Until the enactment of this law, E&P (Exploration and Production) activities were solely subject to the concession regime. Although this is still utilised in Brazil – and under the 11<sup>th</sup> Bidding Round that took place in May 2013 a total of 142 blocks onshore and offshore were awarded under the concession regime – the new regulatory framework will apply to activities in fields located in the pre-salt area.

Known formally as the 1<sup>st</sup> Production Sharing Bidding Round (from now on this article will refer to it simply as the 1<sup>st</sup> Bidding Round) the tender will offer, under the new regulatory PSA regime, the offshore Libra field, located in the Santos Basin in an area covering 1,548 square kilometres which according to ANP has an estimated recoverable volume of between 8 and 12 billion barrels.



### Invitation to Bid

On July 9<sup>th</sup> 2013, ANP published a preliminary Invitation to Bid containing the rules, procedures and schedule applying to the 1<sup>st</sup> Bidding Round as well as the related draft PSA.

### Registration of Interest with the ANP/Qualification/Submission of Bids Schedule

By September 9<sup>th</sup> 2013, companies interested in participating in the 1<sup>st</sup> Bidding Round must register their

interest and present the documentation required by ANP relating to their technical, economic, financial and legal qualifications.

Offers will be submitted on October 21<sup>st</sup> 2013 and the PSA to be entered into between ANP and the winning consortium is expected to be executed in November 2013.

### Qualification Requirements

Companies will be entitled to participate of the 1<sup>st</sup> Bidding Round

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provided that:

- I. they confirm their interest in the bidding process;
- II. they pay, individually, the participation fee of R\$2,067,400; and
- III. they meet the technical, legal and financial qualification requirements set forth in the Invitation to Bid.

## Petrobras is the operator and is entitled to a minimum participation of 30% in the winning consortium

The winner of the 1<sup>st</sup> Bidding Round will be required to form a consortium with PPSA (a state company responsible for managing the PSAs) and Petrobras – which under the new regime will always be the operator on blocks contracted under a PSA and will be entitled to a minimum share of 30% in the consortium.

A participating consortium can have a maximum of five companies, which may include Petrobras. However, Petrobras may only participate in one consortium in the 1<sup>st</sup> Bidding Round.

In other words, Petrobras is only entitled to participate directly in one consortium and may choose to do so to increase its interest in the PSA. In the cases where it does not partici-

## THE CONSORTIUM MUST HAVE AT LEAST ONE COMPANY WHICH HAS OBTAINED THE MINIMUM QUALIFICATION AS A LEVEL A BIDDER, WITH CAPACITY TO OPERATE IN DEEP WATERS IN THE CAPACITY OF OPERATOR

pate directly, it will still participate in the E&P activities as the operator (as this is determined by law), with the above-mentioned minimum 30% percentage in the consortium. In this case it will have to accept the terms of the winning offer, including the signature bonus.

Companies bidding under a consortium will have to qualify individually, but the consortium must have at least one company which has obtained the minimum qualification as a Level A bidder, with capacity to operate in deep waters in the capacity of Operator. The consortium may have other companies qualified under Level B, with capacity to operate onshore and in shallow waters. Finally, a consor-

tium must undertake to establish a Brazilian company to sign the PSA.

### Bidding Guarantee

The bidding company, or one of the members of the consortium, must provide ANP with a bidding guarantee of R\$156,109,000.

A guarantee will be enforced where a company, having won the bidding process, fails to execute the PSA within the deadline set forth by the ANP; if the PSA is not executed with any of the companies forming the winning consortium or an affiliated thereof; or if the winner decides not to proceed with the offer and not to sign the PSA within the deadline established by ANP.

### Signature Bonus, Offers and Profit Oil

The signature bonus, which is the amount to be paid by the winning bidder to the Government, has been established at R\$15 billion.

Under a PSA, once a discovery is made, the oil companies which are a party to the agreement are reimbursed by the Government for their operational costs – and this is the “cost oil”. Profit Oil is the amount of production after such deduction of

the cost oil takes place.

The winner of the 1<sup>st</sup> Bidding Round will be the bidder which offers the largest profit oil to the Government. Offers shall indicate the percentage of profit oil being offered, which in any circumstance must not be lower than 41.65%.

Other important features are as follows:

### IV. Minimum Exploratory Program

**gramme:** this corresponds to the set of exploratory activities to be performed by the contracted party. The Minimum Exploratory Program must be mandatorily fulfilled during the Exploration Phase; and

### V. Local Content Undertaking:

“local content” is the proportion between the amount applying to equipment manufactured and services rendered in Brazil for the execution of the production and share agreement and the total value of the goods and services under the agreement. Under prevailing rules in Brazil, the contracted party must observe a minimum percentage of participation of Brazilian companies in the supply of equipment and services under the agreement.

The following Local Content indexes apply:

VI. Exploration Phase, with a duration of four years:

Deep waters/Super deep waters: minimum of 37%

VII. Development Stage (Modules with first oil until 2021):

Deep waters/Super deep waters: minimum of 55%

VIII. Development Stage (Modules with first oil from 2022):

Deep waters/Super deep waters: minimum of 59%

Finally, the draft PSA that regulates the relationship between Petrobras, Pré-Sal Petróleo and the other companies in the winning consortium has also been published. It will have a validity of 35 years from the date of its signature, starting with the Exploration Phase. ●

# ARTICLES

## A FEW COMMENTS ON BRAZIL'S ACCESSION TO THE UNITED NATIONS CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS

BY DANIEL VARGA

ASSOCIATE LAWYER AT NABAS LEGAL INTERNATIONAL LAWYERS

ARTICLES

The United Nations Convention on Contracts for the International Sale of Goods (CISG) is a uniform law applicable to contracts for the international sale of goods. It has been widely adopted both by developed and emerging economies, though not by the United Kingdom.

With Brazil recently having become the 79<sup>th</sup> State party to accede to the CISG, it will come into force in the country on April 1<sup>st</sup> 2014. However, Brazil's accession raises issues concerning the compatibility of Brazilian contract law with the CISG's provisions. Certain principles enshrined in Brazilian law seem to be at odds with the convention, such as the social function of the contract and the extent to which good faith is applied.

The CISG is based on two main principles: first, regarding its interpretation and application, consideration has to be given to its international character, which means the convention is not bound by any specific jurisdiction: it is an autonomous international law. Second, the convention aims to promote uniformity, which means its application and interpretation shall follow common standards regardless of the jurisdiction in which it is being applied.



Although the CISG aims to promote uniformity and regard is to be given to its international character, legal academics have observed that national courts are usually influenced by what has been labelled 'homeward trend', which is to say the tendency of the

national court to interpret and apply the CISG based on its own legal system instead of taking into account the convention's international character. Hence, the homeward trend may potentially cause conflict between national law and the international convention.

The social function of the contract is provided in article 421 of the Brazilian Civil Code which basically states that freedom of contract shall be limited by the social function of the contract. Brazilian law does not provide further clarification on this matter. However, this principle has been interpreted by legal academics and developed by the courts. When entering into a contract, parties must pay attention to consequences for third parties not directly engaged in the contractual relationship. It is said that although the concept may be difficult to define, it can be understood by its application on a case-by-case basis. To sum up, the social function of the contract imposes a general duty to respect and observe third-party interests when entering into a contract. There is no similar provision in the CISG, and some foreign practitioners may even find it hard to decipher its meaning.

The principle of good faith is not an alien concept to the CISG. Its article 7(1) states that 'in the interpretation of this Convention, regard is to be had to its international character and to the need to promote uniformity in its application and the observance of good faith in international

### ACCORDING TO THE BRAZILIAN COURTS, THE PRINCIPLE OF GOOD FAITH IMPOSES ETHICAL OBLIGATIONS FOR PARTIES ENTERING INTO A CONTRACTUAL RELATIONSHIP

trade.' However, the application of the principle by Brazilian courts may reach far beyond what is intended by the CISG. According to the Brazilian courts, the principle of good faith imposes ethical obligations for parties entering into a contractual relationship. This means that in every contractual relationship parties are bound by collateral obligations which may not be either explicit or implicit in their agreements. This also mitigates the freedom of contract because parties may be required to follow certain rules which were not envisaged by them. Although the CISG expressly refers to the observance of good faith in international trade, this refers to an interpretation rule rather than a principle imposing general duties.

The issues addressed above pose the following question: are Brazilian practitioners prepared to deal with discrepancies between Brazilian legal culture and the text of the CISG?

Although in the last few years Brazil's economy has become significantly more open to the rest of the world, Brazilian judges and lawyers still tend to be unfamiliar with international issues. This might give rise to homeward trend and lead to the misapplication of the convention. In order to avoid such a scenario, the onus is on Brazilian legal professionals and legal academics to engage in further analysis of the convention. ☉

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## CHANGES IN THE BRAZILIAN POWER SECTOR: BOOSTING COMPETITIVENESS AND INVESTMENT OPPORTUNITIES

BY MARIA JOÃO ROLIM  
PARTNER AT RV&LC ADVOGADOS

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**S**eptember 11<sup>th</sup> 2012 saw the introduction of Provisional Measure No. 579, (PM 579) which aimed to provide a solution for the electricity concessions contracts which were coming to an end and also to enable final prices for residential, commercial and industrial consumers to be reduced while still stimulating investment in the sector. The measure provides for the renewal of concessions for the generation, transmission and distribution of electricity and establishes measures to reduce the sectorial tax burden in order to obtain reasonable prices. Designed to promote security of supply and to increase competitiveness in the sector, PM 579 became Law No. 12,783 on January 11<sup>th</sup> 2013, regulated by Decree No. 7805/2013.

Prior to these legislative changes the scenario of electricity concessions extensions were outlined in three situations i) generation, transmission and distribution concessions of electricity existing before 1995 and owned by companies that would be privatised: the act of alienation (the transfer of property), asset buyers could sign new concession contracts with the Union for a maximum period of 30 years,

renewable for an equal period, ii) “new awards” granted starting from 1995: for generation concessions, hydroelectric plants would have concessions for 35 years, renewable for the same period, whereas the segments of transmission and distribution would have concessions for 30 years, also renewable for the same period; iii) generation, transmission and distribution concessions prior to 1995, held by companies that did not come to be privatized: there was a ‘transition rule’ which would bring old licenses up to the standards of the new industry model, delegated by decree held by companies that, perhaps, would not be privatized in the short or medium-term. Two situations were forecasted: (a) concessions already expired: dealers would sign a contract to extend it for 20 years, from 7/7/1995, expiring on 7/7/2015, and (b) concessions to be awarded: dealers would sign a contract that would extend for 20 years from the expiration date.

Since 2001, however, after the crisis experienced by the power sector, changes have been introduced such as Law no. 10,848/2004, which included a provision for modification about grants and renewals of concessions for electricity generation which were

introduced by Law no. 9,074/1995. Thus, for generation concessions which: (i) were granted between 7/7/1995 and 12/11/2003: the concession was kept within 35 years and the period for extension was reduced to 20 years; (ii) concessions granted from 12/11/2003: the 35-year-term was kept, but the right to request an extension was removed.

This produced a situation where around 80% of transmission and 20% of hydro-generation concession contracts were about to expire by 2015, which led to a discussion about the legal possibility of extending the contracts. An initial interpretation of the Brazilian Constitution, particularly Article 175 which provides for the concession of public services, indicated that a new tender would have to be organized in order to grant new contracts to the incumbents. The process, however, was thought to be expensive and could lead to an increase in the price of electricity, with a consequent negative impact on the country's competitiveness.

In the midst of a highly controversial discussion about the need for a constitutional change, PM 579 was enacted to introduce significant changes to the way the sector is or-



Itaipu Dam

ganized. As a result, since the legislation came into effect, the power sector has undergone considerable restructuring, particularly with regard to the new regime of energy quotas and the reduction of sector charges.

Accordingly, expired concessions could be extended for a period of 20 years providing electricity and capacity originated from their assets considered already amortized; the ‘old’ energy would be allocated to captive market and priced as a rate of O&M

pre-determined by ANEEL.

The new model adopted for the recruitment of new energy has been referred to as a ‘quota system’. According to this methodology, the physical security of the plants will be renewed prorated among the concessionaires, according to criteria to be determined by ANEEL, and the cost to be paid will be the O&M rate. The calculation of O&M, defined by the Agency, will have as a parameter a methodology applied to the distribution companies,

using information from the database that will serve as the basis for fixing the ceiling price of energy auctions and transmission.

In addition, in order to reduce the tax burden on the sector, some sector-specific taxes have also been reduced: the Fuel Consumption Account (CCC) and Global Reversion Reserve (RGR) taxes were removed, while the Energy Development Account (CDE) tax was reduced by 25%.

Finally, it is worth mentioning that

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the legislation provides for compensation to the investment value of the reversionary property not yet amortized or depreciated over the New Replacement Value (VNR methodology).

Though PM 579 has faced criticism from the industry, the changes it introduced have also created opportunities. The Government extended the concessions deadlines because it was aiming for continuity, efficiency in public service delivery, and reasonable prices. Also, with Brazil depending on hydropower to meet around 70% of its electricity needs, the debate surrounding PM 579 has drawn attention to the need for investment in alternative fuel sources. If this is going to happen, a friendly investment environment needs to be maintained. As part of this policy, source-specific tenders are expected to be put in place as well as regional auctions focused on releasing transmission capacity. In this context, on August 23<sup>rd</sup> 2013 a specific tender is to be held granting investors 20-year Power Purchased Agreements (PPAs) and some tax incentives for renewable sources (Tender nº 05/2013).

Given the scope of the changes which have taken place, the market players are still coming to terms with

the new forms of operation. The way ahead might lie in cutting costs and in keeping an eye on merger and acquisitions opportunities as a means of expansion. The Government, meanwhile, faces increasingly demanding sustainability issues and has to deal with the question of how to improve competitiveness without compromising the much-needed investment in new generation and interconnection. Promoting a stable and friendly environment for new investment in alternative fuel sources might be part of the answer. ●

# BRAZIL HAS A COMPREHENSIVE PORTFOLIO OF ENERGY DERIVATIVES

BY FABIANA PEROBELLI

AGRICULTURE PRODUCTS MANAGER AT BM&FBOVESPA

With its fully integrated business model the Brazilian market offers not only a state-of-the-art trading environment but also registration, clearing, settlement, risk management, central counterparty and depository services.

The portfolio of energy commodity derivatives in Brazil contains four products. These are cash-settled hydrous ethanol options and futures, anhydrous fuel ethanol futures with physical delivery, cash-settled crystal sugar futures and options, and cash-settled mini oil futures.

This diversity in energy products

results from efforts to develop Brazil's commodity derivatives market and represents the real possibility of transforming the country into the global bellwether for ethanol market prices.

The reference for ethanol trading in Brazil is the hydrous ethanol price in the Paulínia/SP region, which is the largest fuel distribution hub in the country. This price is a reference both for trades on the domestic market and for international trading.

In the graph below we illustrate the evolution of hydrous ethanol prices in Paulínia, in Brazilian reals and in US dollars. These prices can be used as a reference for Brazilian ethanol trades and also enable arbitrage with

other exchanges.

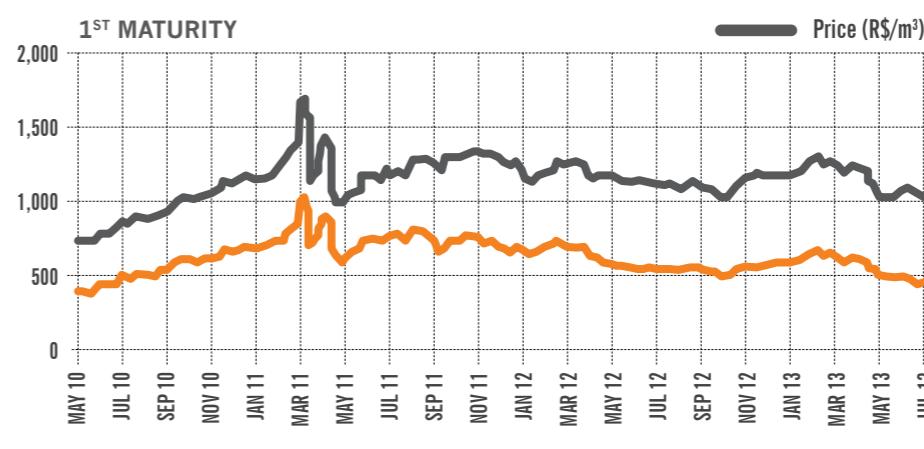
## Oil derivative

In June this year the energy portfolio gained a mini futures contract that references the settlement price of the CME Group's NYMEX Light Sweet Crude Oil (WTI) contract. This launch was part of an agreement to promote the cross-listing of futures contracts with our strategic partner the CME Group.

The mini contract allows participants in the oil production chain (producers, refiners, fuel distributors and importers) to execute hedging strategies to manage risks in the energy market.

THE REFERENCE FOR ETHANOL TRADING IN BRAZIL IS THE HYDROUS ETHANOL PRICE IN THE PAULÍNIA/SP REGION, WHICH IS THE LARGEST FUEL DISTRIBUTION HUB IN THE COUNTRY

## EVOLUTION OF HYDROUS ETHANOL PRICES ON BM&FBOVESPA



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In the table below we list the main characteristics of the energy derivatives contracts available on the Brazilian market.

This basket of products allows energy market players to execute hedging and arbitrage strategies between contracts, in local currency and on a single electronic trading platform. It also enables arbitrage between the Brazilian market's several contracts and the products listed on other exchanges.

## Market Makers

Since its inception, the oil mini futures contract has had a Market Maker program to promote liquidity. Through a competitive bidding process open to the market, the institutions Virtu Fi-

nancial Ireland Limited and Banco BTG Pactual have been selected as Market Makers. The Market Maker program will also be extended to crystal sugar and hydrous ethanol contracts in the second half of 2013 and will be open to foreign institutions.

## How to access the market

In June, non-resident investors had a 25% share of all of the contracts traded in the derivatives segment and a 44% share of the financial volume in the equities market.

To trade Brazilian assets, non-resident investors must be registered with the Securities and Exchange Commission of Brazil (CVM). This takes place through a 2689 account

which allows trading in equities and financial or commodity derivatives, or a 2687 account exclusively for agricultural derivatives. ●

# INTERVIEW



## PAULO SKAF

BY IEDA GOMES  
THE BRAZIL BUSINESS BRIEF

### PRESIDENT OF FIESP, CIESP, SESI-SP, SENAI-SP AND IRS\*

**P**aolo Skaf is the president of the largest group of industry associations in Latin America, including the Federation of Industries of the State of São Paulo (FIESP). He has been awarded several honours, including the Order of Rio Branco by the Brazilian Ministry of Foreign Affairs.

**Until recently Brazil was considered the most promising BRIC economy, with a diverse industrial and financial base, huge energy resources, a growing middle class, inflation firmly under control, and near double-digit GDP growth. What went wrong?**

In fact, much of that is still true. Brazil hasn't really changed for the worse.

It still has one of the most diverse industrial structures, one of the most solid financial systems, plenty of energy resources, and a middle class which is still expanding, albeit at a slower pace than before. Yes, there's been a fall in the rate of GDP growth, but the country has the potential to quickly regain the lost momentum because the positive structural fac-

	ANHYDROUS ETHANOL	HYDROUS ETHANOL	CRYSTAL SUGAR	MINI-SIZED WTI CME
UNDERLYING COMMODITY	ANHYDROUS FUEL ETHANOL	HYDROUS FUEL ETHANOL	SPECIAL CRYSTAL SUGAR	WTI FROM CME GROUP
CONTRACT SIZE	30 CUBIC METRES (30,000 LITRES)		508 BAGS OF 50-NET KILOGRAMS	100 BARRELS
PRICE QUOTATION	BRL PER CUBIC METRE, FREE OF TAXES		BRL PER 50 NET KILO BAG, FREE OF TAXES	USD PER BARREL
PRICE FORMATION	PAULÍNIA/SP		SANTOS/SP	CME GROUP
SETTLEMENT	PHYSICAL DELIVERY	CASH-SETTLED		
PORTFOLIO	FUTURE	FUTURE AND OPTION	FUTURE AND OPTION	FUTURE

Source: BM&FBOVESPA

# INTERVIEW

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tors are the same. The issue is that recently there has been a fall in the expectations of a significant part of the market, which can give a misleading impression of how the country is actually doing. It's true that Brazil is an expensive economy to invest and produce in, due mostly to structural deficiencies, high taxes, high interest rates, bureaucracy, outdated infrastructure, the poor quality of public education, and the overvalued exchange rate. Manufacturing industry finds itself in a business environment which isn't very competitive, and this has been central factor in the crisis – it reduces the scope for GDP growth in spite of the expansion of domestic consumption. In summary, however, although our country has problems, it's also true that in direct comparison with the other BRICs it has many strengths.

**It is widely recognised that inadequate infrastructure is a bottleneck restraining Brazil's economic growth. The Government recently launched a 30-year R\$253bn (circa £80bn) infrastructure package. What do you think are the key conditions necessary to attract private and international investors?**

The Government announced the Logistics Investment Programme in

## THE PRIVATE SECTOR IS RESPONSIBLE FOR THE CONSTRUCTION, MAINTENANCE AND OPERATION OF THE NETWORK WHILE VALEC, THE PUBLIC RAILWAY ENTERPRISE, PURCHASES THE RAILWAY'S FULL CAPACITY OF TRAFFIC AND CARGO AND OFFERS ITS CAPACITY TO THE MARKET

2012 with the aim of expanding and modernising the country's infrastructure network. The programme's main objective is to change the regulatory framework by increasing private-sector participation in investments and putting the State in its proper role as a planner, regulator and supervisor.

**At the moment there is virtually full employment in Brazil and yet there are deficiencies in education and shortages of key skills which make it difficult for the country to cope with an increasingly demanding and competitive business environment. What are government and indus-**

the public railway enterprise, purchases the railway's full capacity of traffic and cargo and offers its capacity to the market, ensuring non-stop traffic over the Brazilian railway network.

**The United Kingdom is now one of the top foreign investors in Brazil and the Prime Minister, David Cameron, visited Brazil in 2012 with a delegation of 40 top British businessmen. In addition to the oil and gas sector, where do you see opportunities for cooperation between Brazilian and British companies?**

By 2011, more than 540 British-controlled companies possessed more than US\$ 41 billion in assets in Brazil. US\$ 17 billion was in manufacturing. Oil and gas is a very promising sector, but other sectors are also attractive to foreign investors – such as beverages, metal products, transport equipment and furniture. Also, UK companies are welcome to invest in high-tech joint-ventures and infrastructure.

**At the moment there is virtually full employment in Brazil and yet there are deficiencies in education and shortages of key skills which make it difficult for the country to cope with an increasingly demanding and competitive business environment. What are government and indus-**

## try doing to address these problems?

The private sector has been making a major effort in this respect. Brazilian industry supports two educational systems, SESI and SENAI. SESI-SP is one of the largest networks of private schools in Brazil – a total of 175 schools in 112 municipalities, providing quality education for more than 179,000 students. In turn, SENAI-SP is the biggest professional and technological education institution in Latin America, with 90 stationary units and over 74 mobile ones. In 2012 its diverse modalities courses had more than 970,000 students enrolled.

Moreover, due to the failings of the Brazilian educational system, companies also provide their employees with several types of extracurricular training and instruction.

But it is still necessary to make major improvements to public education. The first step would simply be to allocate more resources. Between 1999 and 2008 the average public expenditure on education per pupil in Brazil was US\$ 978, while the average across Latin America was US\$ 1,050. FIESP believes the proceeds from oil exploration should indeed go towards education – but there is also the issue of efficiency. In the same period Brazil

managed to provide an average of only 6.1 years of schooling per child, as against the Latin American average of 8.3 years. Our neighbours, therefore, were spending an extra 7.4% per pupil but providing 35.2% more schooling. As for the average scores obtained in the PISA test – an international exam for students developed and managed by OECD – Brazil ranks 52nd. Among the countries with a similar level of spending per pupil, only in Colombia do children do worse than their Brazilian counterparts.

**São Paulo is the top region for foreign direct investment (FDI) in Brazil, attracting more than 25% of the total. What is FIESP's role in this, and what advice would it offer to companies looking to invest in São Paulo?**

FIESP is the main interlocutor for the Brazilian productive sector, representing 130,000 companies. We have 42 offices spread across the state of São Paulo and a very diverse set of sectorial committees which are very well equipped to facilitate foreign investors' access to whichever industry is of interest to them. FIESP regularly offers international business rounds, technical and thematic meetings, and seminars on investment opportunities for those considering investing not only

in São Paulo but in Brazil as a whole. **Under your leadership FIESP has led several campaigns in the areas of energy and infrastructure. What do you consider your key achievements and your priorities for 2013?**

## Energy

In the energy sector FIESP's main priorities for 2013 include the return of oil and natural gas auctions. The most recent petroleum auction took place five years ago, a fact which has discouraged international investors and had a negative effect on the supply chain of the oil and gas industries. To meet domestic demand Brazil has had to import large quantities of hydrocarbons, thereby affecting the balance of trade. For FIESP, therefore, the return of the auctions is a cause for celebration. In May the 11th Bidding Round aroused great interest among investors. We're looking forward to the auctions for Libra, the first pre-salt block, in October this year, and to the unconventional gas auction, expected to be in November. It is only with the return of the auctions that the country will move towards to self-sufficiency.

The increase in the supply of natural gas is a key factor for reducing prices and ensuring competitiveness.

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FIESP is studying the suitable sectorial policy and regulatory framework for a fair price for natural gas.

Another key step for Brazil's development is to increase electricity supply to meet demand. As things stand, thermoelectric power plants are the only option due to the shortage of hydroelectric power projects with large reservoirs. Only a third of our hydropower potential has so far been exploited – that's why FIESP is in favour of hydroelectric power plants with reservoirs. Of all the options for expansion it's the only one that combines reliability, price, and lower greenhouse gas emissions.

## Ports

FIESP has this year played an important role in supporting the bill that lays out new rules for the ports sector. At the end of last year President Rousseff brought in a provisional measure to modify the ports legislation. One of the main changes was an end to the restrictions on private terminals handling third-party cargo. And the selection criteria for port auctions will now be a combination of low price and high cargo-handling capacity. The goal of all these changes is to ensure competitiveness and efficiency.

## ONLY A THIRD OF OUR HYDROPOWER POTENTIAL HAS SO FAR BEEN EXPLOITED – THAT'S WHY FIESP IS IN FAVOUR OF HYDROELECTRIC POWER PLANTS WITH RESERVOIRS

The measure faced resistance mainly from operators of public ports worried about the competition arising from the end to the restrictions on private terminals. FIESP had strongly supported the government in its reform of the legislation, using adverts in high-circulation newspapers and campaigns on primetime television to inform the population about the benefits of the new legislation. The measure was approved by Congress and signed into law by the President in June.

## Urban Mobility

This year has been marked by popular demonstrations across the country demanding improved public services along with lower bus fares in São Paulo and many other cities. This draws our attention to the serious problem of

urban mobility. In the last decade, due to the population's rising income, the number of cars on the streets has increased. Only if there is a high-quality public transportation system will people be persuaded to leave their cars at home and start to use the bus, subway or train. Brazilian cities – particularly São Paulo – need to have wide-ranging, modern urban mobility plans. FIESP is closely following this issue, believing as we do that traffic jams and low-quality public transport reduce Brazilians' quality of life and produce immeasurable costs for industry.

## What do you consider your main legacy for future generations?

My aim has been to construct a better Brazil – one that is both more competitive and fairer. Particularly with regard to education, we are carrying out a revolution. We will open 100 schools this year, with full-time teaching, and we're also expanding the supply of technical courses and creating new universities. Education can change people's lives and lay the foundations for a better country in the future. ●

\*FIESP: Federation of Industries of the State of São Paulo / CIESP: Industrial Association of the State of São Paulo / Senai: National Service for Industrial Training / Sesi: Social Service for Industry / IRS: Roberto Simonsen Institute.

# DATES FOR YOUR DIARY

11<sup>TH</sup> SEPTEMBER

RECEPTION IN THE HOUSE OF COMMONS  
7PM - SPONSORED BY LATAM AIRLINES GROUP



18<sup>TH</sup> SEPTEMBER

COUNTRY RISK IN SOUTH AMERICA  
DAC BEACHCROFT - 8:30 AM

FOR MORE INFORMATION PLEASE VISIT OUR EVENTS PAGE AT  
[BRAZILIANCHAMBER.ORG.UK/EVENTS](http://BRAZILIANCHAMBER.ORG.UK/EVENTS)

DATES FOR YOUR DIARY

# EVENTS ROUND-UP

THE BRAZILIAN CHAMBER ORGANISES AROUND 20 EVENTS PER YEAR ON A VARIETY OF SUBJECTS, ALWAYS AIMING TO RAISE THE PROFILE OF BRAZIL AND TO PROMOTE NETWORKING OPPORTUNITIES. ON OUR PAST EVENTS PAGE YOU CAN DOWNLOAD PRESENTATIONS, SEE PICTURES AND LEAVE COMMENTS.

FOR MORE INFORMATION PLEASE VISIT [WWW.BRAZILIANCHAMBER.ORG.UK/PASTEVENTS](http://WWW.BRAZILIANCHAMBER.ORG.UK/PASTEVENTS)

EVENTS ROUND-UP



## RECEPTION TO INTRODUCE THE NEW BRITISH AMBASSADOR TO BRAZIL, MR ALEX ELLIS

JUNE 5<sup>TH</sup> 2013

Alex Ellis was appointed Her Majesty's Ambassador to the Federative Republic of Brazil in July 2013, succeeding Mr Alan Charlton.

More than 150 members and friends of the Chamber joined us to meet him, enjoy a few caipirinhas, and listen to authentic Brazilian music by Clube do Choro UK.

Mr Ellis joined the FCO in 1990 and has worked on EU and global issues both in the FCO, most recently as Director of Strategy, and in the

private office of the President of the European Commission. He speaks fluent Portuguese.

Paul Hennemeyer from Boa Vista Advisory was the lucky winner of the prize draw for a one-night weekend stay at the prestigious Millennium Hotel London Mayfair.

**MILLENNIUM HOTEL LONDON MAYFAIR**

## SUMMER BBQ

JULY 17<sup>TH</sup> 2013

About 120 members and friends of the Chamber attended our barbecue, taking advantage of the hot weather to network in a lively atmosphere and enjoy music from Clube do Samba UK. For the third consecutive year the event took place in the attractive surroundings of Dartmouth House. ☺



Summer BBQ

## EVENTS ROUND-UP



Summer BBQ



Clube do Samba UK



Summer BBQ



Elcio Gomes Rocha and Paulo Guimaraes of Banco do Brasil

## BRAZILIAN ECONOMY: RECENT PERFORMANCE, BUSINESS OPPORTUNITIES AND CHALLENGES AHEAD

A PRESENTATION BY ELCIO GOMES ROCHA,  
CHIEF ECONOMIST OF BANCO DO BRASIL  
JULY 4<sup>TH</sup> 2013

The presentation provided a thorough overview of the Brazilian economy in recent years, focusing on macroeconomic stabilisation and the major structural shifts which have created good conditions for sustained economic growth. ☺

**BANCO DO BRASIL**

 Freshfields Bruckhaus Deringer

# EDITORIAL

## BRAZIL BUSINESS BRIEF SEPTEMBER 2013

NEWS FROM THE  
BRAZILIAN CHAMBER OF COMMERCE  
IN GREAT BRITAIN

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PICTURES BY RONALDO BATALINI // SMILE PHOTOGRAPHY

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