



BR do MAR

CABOTAGE INCENTIVE PROGRAM

Bill of Law N° 4199/2020

NATIONAL SECRETARIAT OF PORTS
AND WATERWAY TRANSPORTATION
Department of Navigation and Waterways

» NEWSLETTER

AUGUST 2020

OBJECTIVES

- I. **Increase the offer** and quality of cabotage transport;
- II. **Encourage competition and competitiveness** in the cabotage transport services provision;
- III. **Increase fleet availability** in the national territory;
- IV. **Support the training and professional qualification** of national seafarers;
- V. **Stimulate the development** of the national naval industry of cabotage;
- VI. **Review the binding** of the cabotage navigation policies with the shipbuilding policies;
- VII. **Encourage special cabotage operations** and the resulting investments in port facilities, for handling cargo in type, route or market that do not yet exist or is not yet consolidated in the Brazilian cabotage;
- VIII. **Optimize the use of resources** from the collection of AFRMM – (Additional Freight for the Renewing of the Merchant Marine).

GUIDELINES

National security
Regulatory stability
Regularity of provision of transport operations
Optimization in the use of chartered vessels
Balance the Brazilian logistics matrix
Encouraging private investment
Promotion of free competition
Optimizing the use of public resources
Recruiting and professional qualification of national seafarers
Innovation, scientific, technological and sustainable development
Transparency and integrity

WHAT IS THE MAIN CHANGE THAT BR DO MAR PROPOSES?

The **BR do Mar program** aims to facilitate the expansion of cabotage operations and the entrance of new companies. The main proposal of change in the legislation is to increase the possibilities for EBN's to charter vessels, without **the obligation to have their own vessels**. This change is being proposed in a balanced way, maintaining an incentive for companies to have their own fleet, which contributes to the main characteristic sought by potential cabotage users: **regularity**.

COMPREHENDING THE SECTOR

BRAZILIAN NAVIGATION COMPANY (EBN)

Legal entity constituted according to Brazilian laws, headquartered in the country, whose object is waterway transportation, and which is authorized to operate by ANTAQ. Its capital can be 100% of foreign origin.



CHARTERPARTY CONTRACT

When a company hires a vessel from another company.

VESSEL SHIPOWNING

Providing the vessel with what is necessary for its operation (e.g. crew).

BAREBOAT CHARTER

The EBN that chartered the ship provides its crew and provisions. It's like renting a transport truck and the user is the one who drives, loads, etc. The EBN operates the vessel. In this type of contract, the ship must be registered in Brazil under the Brazilian flag.

TIME CHARTER

The EBN hires the service of a third party, who manages the vessel. It is like hiring a transport truck, and the driver and helpers are from the moving company. The vessel operator is the third party. In this type of contract, the ship maintains the registration of its country of origin, in general one with low taxation.

VESSEL'S FLAG

It's the country where the vessel is registered. The vessel follows the rules of the country where it is registered (tax, labour, etc.). Don't confuse with the country where the vessel was built.

NAVIGATION IN THE WORLD

- I. There is a significant concentration of companies in the international market, notably in the container segment. Economies of scale and network effect contribute to this concentration.
- II. The economic impact for countries that do not have a fleet domain and depend on the fleet available in the market are relevant. The effects for Brazilian exporters have been reported on several occasions involving both the volatility of freight and the availability of containers.
- III. International freight is very volatile, both in bulk (figure 1) and in the container (figure 2)

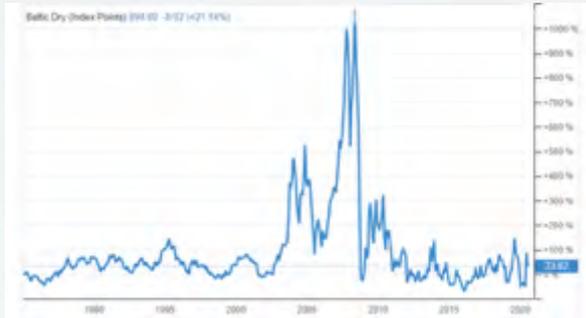


Figure 1 – Baltic Dry Index

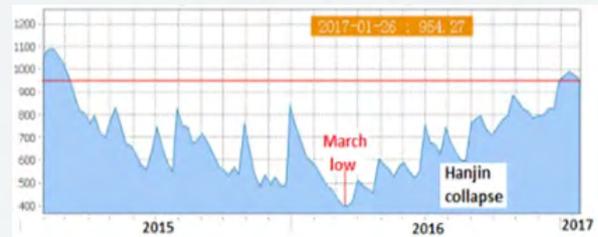


Figure 2 – Shanghai Containerized

- IV. The variation in freight is the result of investment decisions and demobilization of vessels by ship owners (shipping companies) as well as the demand of the different markets that use navigation. An increase in Chinese demand impacts freight worldwide.
- V. There are countries that adopt laws to attract the registration of vessels. Taxation in these countries is low. Much of the international fleet is registered in one of these countries.
- VI. According to the Organization for Economic Cooperation and Development (OECD), most developed countries have policies to encourage maritime transport to maintain a fleet linked to their respective markets.
- VII. Protection of maritime cabotage transport is practiced in important world economies, including the most liberal ones, and exists in 80% of coastal countries that are members of the United Nations. **One of the most protected countries is the USA**, where only ships built in the country, owned by an American company, with a crew of nationals can operate in cabotage. In Australia, the market has opened, but it had to be reversed in 2012 after negative results for the regularity of cabotage transport. **In Europe**, navigation between member countries can also only be done by European companies.

CABOTAGE IN BRASIL - CURRENT SCENARIO

- I. Ruled by Law nº 9.432/1997. It can only be done by the EBNs.
- II. The EBNs can operate their own or chartered vessels.
- III. The operation of a ship under a Brazilian flag (owned vessel or bareboat chartered) can cost 70% more than a time chartered foreign vessel.
- IV. The EBNs can only bareboat charter ships that correspond to 50% of its own fleet. If it has two vessels, it can only charter one (1). In other words, **only the companies that have vessels under their own property can bareboat charter**.
- V. The EBNs can time charter when there is no vessel under a Brazilian flag available.
- VI. ANTAQ controls the availability of vessels under the Brazilian flag, through SAMA (Chartering System in Maritime and Support Navigation). For each time charter, ANTAQ asks the EBN if it has a vessel under Brazilian flag that would be available to make the transport in place of the one that is to be chartered.

¹ Actually, the Law considers the vessels' tonnage, not the number of vessels. And there are rules for "rounding" the result.

AFFREIGHTMENTS FLEXIBILIZATION

Problem: how to combine cost reduction with the maintenance of freight predictability? Three important assumptions: time chartering third-party vessels exposes the domestic market to the volatility of the international market. Volatility reduces the cargo migration from road transport to cabotage. On the other hand, the obligation to use the Brazilian flag increases the costs. What is the solution?

BR do Mar: A company qualified in BR do Mar may charter vessels from its **wholly owned foreign subsidiary** for a period of time. Although chartered in time, the operation will be carried out by the EBN, via a subsidiary established in a country that respects the Maritime Labour Convention (MLC) when:



- I. Based on a proportion (to be defined in Decree) of the owned ships: this hypothesis creates incentives for the formation of a national fleet. The larger the own fleet, the greater the access to ships that operate at a lower cost. This hypothesis also balances competition between companies that have already invested in Brazil, and, therefore has higher costs, and those that can enter the market without any investment (bareboat chartering without BR tonnage);
- II. In substitution of a vessel under construction in the country: in this case, incentives are maintained for the national industry, since, if EBN is building a vessel in Brazil, it may charter 2 times the quantity that is under construction;
- III. Replacing a vessel under construction abroad;
- IV. Replacing a vessel under repair;
- V. For exclusive service of long-term transport contracts: this hypothesis allows an alternative for companies who have enough volume to “close” the capacity of a vessel; and
- VI. For the provision of special cabotage operations, for up to 4 years: it will operate as a long-term circularization. If a certain operation has not yet been done by an EBN with a Brazilian vessel, then the company can perform a “test” of this new market, without having to invest in the own vessel first.

MAJOR BUSINESS ATTRACTION TO CABOTAGE

With the special operations and long-term contracts, new shipowners will be able to start operations in Brazil with time chartered vessels without the obligation to have their own vessel. In addition to these alternatives, there will be an option that allows companies to bareboat charter a foreign vessel (under a Brazilian flag) without the need to have a vessel of their own. This flexibility will take place in stages until 2023. These options reduce the company’s capital necessity to enter the market, allowing a greater number of companies in the country.

+ EMPLOYMENT

The Bill N°. 4199/2020 requires a crew composed of at least 2/3 of Brazilians, on time charters, made possible with the strategy of the foreign subsidiary



Today, a significant part of the bulk transport is done with time charters, using foreign crew. Thus, the new hypotheses of BR do Mar will allow Brazilians to have a larger labour market.

In order to afford seafarers availability, the Bill proposes the obligation to provide vacant jobs in chartered vessels for practitioners (trainees) of maritime officers.

LEGAL SECURITY

The temporary admission regime for chartered vessels, without registration of an import declaration, with total suspension of the payment of federal taxes, is already provided for in the Federal Revenue Normative Instruction and is now included in the Law.

NEW INVESTORS

The Bill allows the creation of the Brazilian Navigation Investment Company (EBN-i), which will build a fleet and charter vessels in order to the EBNs operate them, thus eliminating their need for investments in their own fleet (lower Capital Expenditures - CAPEX).

BUREAUCRACY REDUCTION

The Bill imposes that the procedures carried out in ports must be simpler for cabotage transportation than for international trade.



The Bill recognizes the use of digital media as proof of cargo delivery and receipt. It will no longer be necessary to keep the invoice stub.

WHOLLY OWNED SUBSIDIARIES TIME CHARTERING

The time chartering of vessels from wholly owned subsidiaries abroad increases the fleet's availability in Brazil at operating costs closer to the international reality. This alternative maintains the EBN responsible for the operation, allowing greater liability in relation to accidents that occur during the operation, as well as a greater vessel's commitment to the Brazilian market, reducing exposure to the international market.



Haidar Vessel: transport of cattle. Great environmental impacts due to putrefied animals. R\$50 million spent in the vessel's removal, which was executed by the Federal Government.



Oil spill on the Northeast coast: great environmental damage caused by a vessel that had no commitment to the country

IMPORTANT: under the current rules of time chartering (without the BR do Mar rules), the foreign charter controls the navigation! Permitting free chartering by any foreign company means putting Brazilian cabotage in other countries' hands. This situation does not allow the creation of a structured market, because users will always be dependent of the international market, and turns more difficult the accountability of vessel owners in cases of accidents.

HOW DOES SUBSIDIARY CHARTERING WORK?

- I. The EBN (e.g.: "EBN Brasil") constitutes a foreign subsidiary (e.g. "EBN Other Country Ltd"). This operation is simple. Any shipping company is familiar with this type of operation;
- II. "EBN Other Country Ltd" acquires, or bareboat charters, vessels;
- III. "EBN Other Country Ltd" hires the crew (which should have 2/3 of Brazilians). Thus, Brazilians will be working according to the rules of the "Other Country" with reduced costs;
- IV. "EBN Brasil" time charters the vessel from "EBN Other Country Ltd". This operation will effectively have full control of the EBN Brasil, as it will actually charter the vessel from itself, in this case, from its subsidiary;
- V. In this way, the reduction of operating costs is achieved at the same time as the navigation control is maintained by the Brazilian company.

NOTE: the possibility of operating through a wholly owned subsidiary had already been suggested in Law 9432/97.

SHIPPING INDUSTRY

In the last 10 years, despite the incentive that the Merchant Marine Fund (MMF) provides, which is considered a very attractive financial instrument, the Brazilian shipbuilding industry has delivered **only 4 vessels** for cabotage, excluding those that operate with petroleum products (another 26 vessels).

The link between cabotage and the shipping industry discourages the operations expansion. The charter rules from BR do MAR create the conditions for cabotage rapid boost. However, in the short term, those rules do not oblige the EBNs to have the property of their own vessels, which reduces new vessels orders. **Orders that the EBNs already were no longer placing.**

Even if explosive cabotage growth is verified, that would represent few new vessels orders, probably less than 20 in the coming years. There is no meaning for an industrial policy on this scale.

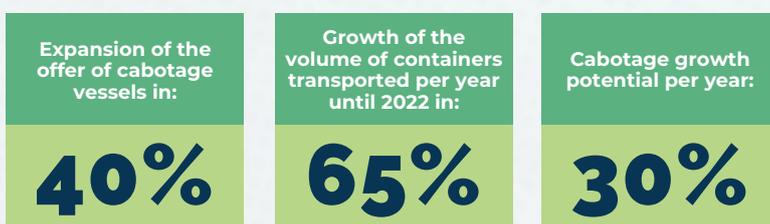
The vessels used in cabotage are standardized, almost commodities. China manufactures hundreds of ships a year at very low costs. International shipyards, even those installed in countries with a long tradition in the shipping industry, have sought to operate in niches, such as the market for technical vessels, cruise ships, wind farms, repairs and the decommissioning of vessels and platforms.

The Brazilian shipping industry presented good results for inland navigation, for maritime support (offshore activities) and port support (tugboats). Recent studies point to opportunities for dismantling vessels used in the oil chain.

On the other hand, BR do Mar proposes new resources for the shipping industry with the following measures:

- Expansion of the use of the resources of binded accounts enabling:
 - Docking and maintenance, including preventive, without any percentage limitation, aiming at an arrangement of a repair portfolio;
 - Guarantee on financing contracts for the construction of vessels;
- Expansion of the use of the Merchant Marine Fund, enabling financing:
 - For foreign companies to build ships in Brazilian shipyards;
 - For docking chartered foreign vessels;
 - For the public company linked to the Navy, for the construction and repair of vessels to be employed in the protection of maritime, auxiliary, hydrographic and oceanographic traffic.

BR DO MAR - EXPECTED RESULTS



AFRMM

ADDITIONAL FREIGHT FOR THE RENEWING OF THE MERCHANT MARINE (AFRMM)

Percentage paid by the cargo owner on the navigation freight: 25% in import; 10% in cabotage; 40% in inland navigation, only for fuels.

USES OF AFRMM

- Collected in imports: 3% is destined to the National Fund for Scientific and Technological Development; 1.5% to the Maritime Professional Education Development Fund; 0.4% to the naval fund; excessive to the Merchant Marine Fund.

- Collected in cabotage and inland navigation: 100% to the EBN, credited in the so-called Binding Account.

MERCHANT MARINE FUND (FMM)

It is a financial fund. The resources are used to finance the construction and repair of vessels and the construction of shipyards. More than 600 vessels have been built using resources from the fund in the past 10 years.

BINDING ACCOUNT

It is the account in the name of each EBN, in which the AFRMM resources from cabotage and inland navigation operations are credited. The Law defines the possible uses for these resources (construction, repair, etc.).

NO INCIDENCE OF AFRMM

In cabotage and inland navigation, with origin or destination in the North and Northeast regions, the cargo's owner does not pay the AFRMM. The EBN is reimbursed for this non-charge, through the original value in AFRMM paid for the import. This resource is essential for the construction of the fleet of convoys that serve the agricultural bulk in the northern arc.

AFRMM EXEMPTION

Different from the non-incidence, it is when a certain product does not pay the AFRMM. In these cases, there is no refund for the EBN.