

ATTACHMENT

Opening remarks and context

All the information presented here can be validated and verified, (see Annex I).

The present background document presents a problem involving PETROBRAS – Petroleo Brasileiro S/A, a state-owned company, on the supply of low sulfur diesel, mandated by law. Such fuel is a *sine qua non* condition for the introduction of new heavy duty vehicle technologies, which in turn are absolutely necessary for urban air pollution control.

In Brazil, the production, distribution, import and marketing of almost all diesel consumed domestically are controlled by PETROBRAS. Its integral subsidiary PETROBRAS Distribuidora S/A – BR, has 7,000 service stations throughout the country and a leading market share of diesel. The Brazilian oil and oil by-products market is in practice a captive market and despite of claims by PETROBRAS that competition is welcome, the population cannot obtain a better quality fuel without the agreement and market involvement of PETROBRAS.

Diesel, the Brazilian market, and public health

Diesel oil is the main responsible for inhalable particulate matter emissions. These emissions are one of the main causes of cardiorespiratory diseases and deaths in Brazil and in the world, especially amongst vulnerable groups such as children and elders.¹

It must be said that there has been significant improvements in air quality in Brazil, mainly due to the effective implementation of the Vehicles' Pollution Control Programme, established in 1986 (PROCONVE – Programa de Controle da Poluição do Ar por Veículos Automotores).² This Programme is based in the European experience.

However, the levels of sulfur in Brazilian diesel are still a major concern, not only from a health and environmental impact point of view but also due to the fact that advanced emission control systems require low sulfur diesel. In order to further reduce the noxious emissions from diesel vehicles the Brazilian Environmental Council (Conselho Nacional do Meio Ambiente – Conama³) established in 2002 that, from January 1st 2009 (a new phase named "P-6"), a higher quality diesel fuel containing up to 50 ppm S (named S-50) would have to

1 To put things into perspective: as an answer to the premature death of 15,000 people per year in the USA due to inhalable particulate matter, in 2002 a public debate led by the Environmental Protection Agency - EPA was initiated in order to promote the reduction of 97% in the levels of sulfur Reference: Environmental Protection Agency - EPA. Diesel Exhaust in United States. 2002

2 Basically, under PROCONVE are established legal limits for new model vehicle emissions, progressively more stringent and embedding new technologies and better quality fuels. A recent research conducted by the Medical School at University of São Paulo (Laboratório de Poluição Atmosférica Experimental da Faculdade de Medicina da Universidade de São Paulo) demonstrated that due to PROCONVE, 14,495 deaths were avoided, just in the metropolitan area of São Paulo), in the period of 1996-2005. If expanded to other metropolitan regions, such as Recife, Rio de Janeiro, Belo Horizonte, Curitiba and Porto Alegre, the number increases to 34,447 avoided deaths. Based on this research the Ministry of the Environment published in 2006 a document evaluating the 20 years of existence of PROCONVE.

3 CONAMA is the consultative and deliberative body of the Ministry of the Environment, created to settle conflicts, propose innovations, and resolve important environmental policy and resource management issues. CONAMA is headed by the Ministry of the Environment and includes broad representation of all sectors of civil society, federal, state, and municipal governments and businesses. Its decisions have legal authority and are applied at the national level. Hence, the decisions from CONAMA must obtain the consent from all its participants.

be available in the market, i.e. distributed countrywide for the new fleet. This legislation, CONAMA Resolution 315/2002 and Federal Law 8.723/93, also determine that a standardised S-50 diesel test fuel should be available for engine development and tests at least 36 months prior to its release, which means January 1st, 2006. Also, it determines that until the Brazilian regulation of the standardised fuel, the European Directives should be observed.

Our concern relates to the non-compliance by PETROBRAS as well as car & truck manufacturers⁴ with the referred regulation and how it has been conducting the discussion process with its external stakeholders.

Since S-50 was not made available for tests on the legally established deadline, several organisations from Brazilian's civil society and other governmental bodies suspected that PETROBRAS and car & truck manufacturers would not comply at all with the Resolution and Federal Law. As a consequence, the matter was taken to court by the São Paulo State Attorney in response to a request by the São Paulo State Environmental Secretary and the Federal Public Prosecutor. A judicial agreement was signed in November 2008.

It is important to explain that the Federal Public Prosecutor in Brazil is an independent body that participates in the trial of cases before the highest courts in Brazil, as an example the Supreme Court (Supremo Tribunal Federal - STF). Federal Public Prosecutors are authorized by the Brazilian Constitution to bring action against private individuals, commercial enterprises, and the federal, state and municipal governments, in the defence of minorities, the environment, consumers, and the civil society in general.

Until the judicial agreement, Brazilian diesel was divided, for quality control purpose, in "metropolitan" (25%) and "ordinary" (75%) varieties. The first one continues with a limit of 500 ppm S (parts per million of sulfur) and it is sold in the main metropolitan regions in Brazil. The latter, distributed to all other regions in Brazil, could contain 2.000 ppm S and is now limited to 1.800 ppm S. The agreement also determined the distribution of S-50, but in a very small quantity and just for a few cities according to a schedule far from the countrywide distribution obliged by law after January 1st 2009.

The distribution of relatively low-sulfur fuel in very restricted areas avoids the introduction of new heavy duty vehicle technologies, which is absolutely necessary for urban air pollution control. In this context, it is important to remember that vehicles – specially the heavy duty ones – circulate all over the country and hence the related exhaust gases are not restricted to any particular area.

Also, the judicial agreement obliges a 10 ppm sulfur diesel after 2013 for the new fleet, but the state-owned company does not give details of its investment and distribution plans, in order to inform clearly when Brazil will have only 10 ppm sulfur diesel, phasing out completely diesel with 500+ ppm sulfur. There's an enormous risk to have in 2013 S-10 just for few cities and in very small quantities, avoiding the introduction of vehicles that require ultra low sulfur diesel and, consequently, compromising the success of PROCONVE.

More recently, Sao Paulo State Public Prosecutor filed a suit against Petrobras, automobile manufacturers and others alleging that the judicial agreement was not strong enough to redress the environmental damage. Also, scientific studies in course point out that the postponement of 50 ppm sulfur diesel from January 2009

⁴ Ford Motor Company, Iveco Latin America, Mercedes-Benz, Scania Latin America, Volkswagen Buses and Trucks, Volvo, Agrale, Toyota, MMC Motors, Nissan, Renault, Peugeot Citroen, Fiat, General Motors, Caa, Cummins, and MWM Internacional South America Motors

to January 2012 could cause 11,000 deaths per year only in the 6 main capitals (see annex I).

Improper publicity and disclosure of information

Additionally, as result of an initiative led by the organisations that subscribe to this letter, PETROBRAS' publicity, where it claims to be environmentally responsible, was also questioned and taken to the National Council of Advertising that self-regulates publicity in Brazil (CONAR – Conselho Nacional de Auto-Regulamentação Publicitária). Although PETROBRAS is one of the biggest advertisers in the country, CONAR decided to prohibit PETROBRAS to affirm in any publicity its responsibility towards the environment, since its behavior was demonstrating the opposite.

Moreover, another episode to be pointed out refers to the fact that PETROBRAS, during the CONAR process, refused to provide access to the information that was part of its defence under the excuse that the information was Government Classified Information, confronting the foundation pillar of transparency of the Global Compact (of which Petrobras is a member) and the Global Reporting Initiative (GRI) as a fundamental component for effective corporate citizenship.

It is also important to remember that Petrobras is a company whose capital mainly belongs to the Federal Government. In this context, it is deplorable that it attempts to impose restrictions to access to information on environmental and health impacts. To illustrate this point, the organisations that subscribe to this letter could not even copy the documents used by Petrobras, since they would be protected by a decree that refers to "the protection of classified data, documents and material that are important to the maintenance of national safety, in the sphere of federal public administration". (Decree n. 4553 of 27/12/2002).

Taking into consideration that the matter refers to the quality of Brazilian diesel and its impacts on human health and the environment, the use of "Government Classified Information" indicates that the company has not respected the rules of transparency, democracy, and participation.

On the lack of compliance with national, international and general guidelines

The "Diesel Case" may be considered as just a part of the business of Petrobras and of the car & truck manufacturers in Brazil and in the world, but it certainly represents a lot more from the Brazilian population's health point of view and definitely tells a lot about the sustainability strategy and corporate citizenship commitments of the companies involved. Principles such as human rights an environment should be an integral part of business strategy, day-to-day operations, and organizational culture, and in the decision-making processes of the highest-level governance body.

The reported facts demonstrate that those enterprises are far from achieving these objectives, creating serious consequences to the Brazilian society as a whole. It's important to remember that PETROBRAS and some of the car & truck manufactures are committed to the Global Compact principles and other initiatives such as GRI. Also, the technology required for the new vehicles are well known by the companies and vehicles attempting more restricted emissions limits are produced in Brazil and exported to foreign developed countries (see annex I). Petrobras recognizes the importance of a better quality for fuels, once the company sponsored last year an event in Paraguay to promote health and environmental benefits of 500 ppm S diesel, aiming to increase its market share (PDVSA offers a 2.000 ppm S diesel). (see annex I)

Taking into account the national and international scientific work, there are no doubts about how poor is the air quality that the Brazilian population is currently being exposed to. Additionally, there is also no doubt regarding the existing correlation between diesel sulfur levels and cardio-respiratory diseases and deaths. Therefore, fundamental rights to life and health, which are essential to the exercise of any other right, are being violated everyday in Brazilian cities.

The Brazilian Federal Constitution establishes the right to life and health (articles 5 and 6). Especially regarding the Rights of children, adolescents and elders, establishes that it is duty of the State to protect their rights to life, health and dignity (articles 227 and 330). It also recognizes in its article 225 that in order to ensure quality of life for present and future generations it is essential to guarantee a healthy and balanced environment.

In the Universal Declaration on Human Rights, the Article 3 states that: "Everyone has the right to life, liberty and security of person". Furthermore, in the Rio Declaration on Environment and Development (1992) the first principle establishes direct correlation between environment and human rights: "Human beings are at the centre of concerns for sustainable development. They are entitled to a healthy and productive life in harmony with nature".

Besides the Universal Declaration on Human Rights and the Rio Declaration, that are understandably basic minimum international standards for the protection of the rights and freedoms of the individual, since the presented facts refer to Brazilian reality, some other provisions must be taken into account.

In the American Convention on Human Rights, ratified by Brazil in 1992, States-Parties must protect rights and therefore have several obligations. It states that: *"every person has the right to have his life respected. This right shall be protected by law and, in general, from the moment of conception"* and, regarding humane treatment, that *"every person has the right to have his physical, mental, and moral integrity respected"* (articles 4th e 5th, 1). The same applies to Children's Rights, as stated in article 19: *"Every minor child has the right to the measures of protection required by his condition as a minor on the part of his family, society, and the state"*. In its Additional Protocol on Economic, Social and Cultural Rights *"Everyone shall have the right to live in a healthy environment and to have access to basic public services"* and *"the States Parties shall promote the protection, preservation, and improvement of the environment"*.

Towards the end of 2008 Petrobras was excluded from the Portfolio Composition of the Corporate Sustainability Index⁵ (ISE) of the Brazilian Securities, Commodities and Futures Exchange⁶ (BM&FBovespa), the third largest Stock Exchange worldwide in terms of market value. The Index, created in December 2005, is based on the international concept of the Triple Bottom Line (TBL) that involves the integrated analysis of environmental, social and economic aspects. To these three TBL principles were added three additional indicators: general criteria, nature of the product criteria (which inquires if the company's product causes damage and risks to consumers health, among other issues), and corporate governance.

The possibility of Petrobras' exclusion was raised after a similar letter sent by these subscribers, arguing that the company wasn't complying with the Brazilian Environmental Legislation and demonstrating very low respect towards

⁵ For the complete methodological exposures see http://www.bovespa.com.br/Market/MarketIndexes/ise_i.shtml
⁶ <http://www.bmfbovespa.com.br/english/Home.asp>

sustainability principles, in spite of current honourable initiatives in the philanthropy area.

To sum up

It is important to say that this is the first time in 20 years that a PROCONVE regulation was not attained. Besides, by maintaining these levels of sulfur and leaving no options to the population in general, this behaviour represents abuse of power and serious violation of human rights by the companies and the Brazilian Government. As opposed to the tobacco case, where individuals can choose if they want to smoke or where non-smokers can choose if they want to breathe the smoke or not, in the Diesel Case the population has no choice. The polluted air and its effects are imposed to everyone: children, pregnant women, elders and adults in general, completely eliminating the fundamental right of an individual's free will.

Particularly in respect to the principles on the environment, which determine that Business should support a precautionary approach to environmental challenges, undertake initiatives to promote greater environmental responsibility, and encourage the development and diffusion of environmentally friendly technologies, it is important to highlight that:

- PETROBRAS has been providing a low quality product as evidences show that an engine using a diesel with high levels of sulfur can deteriorate faster than an engine using a low sulfur diesel⁷. Although PETROBRAS acknowledges the existence of a low sulfur diesel and has the necessary resources and technology to produce it, the company has been resistant in accepting the urge of making it available in the Brazilian market. The product produced by the company nowadays also represents a threat to human health, leaving no option to the population, with disregard to the precautionary principle. As mentioned before, Brazilian oil market is a captive market and the population cannot obtain fuel except from Petrobras. Furthermore, car & truck manufactures had already developed the necessary technology to control the air pollution, which is applied in other countries;
- What is most critical is the fact that although Brazil is a major economy in the developing world, and has the necessary technology to provide a better fuel, the current levels of sulfur are behind Mexico and Thailand (that are adopting the 50 ppm S in 2009) and far behind the USA and Europe (that are using 15 ppm S and 10 ppm S respectively). Brazilian levels of sulfur are compared to countries such as Algeria, Libya, Botswana and Namibia⁸, which currently lack of the mentioned resources and face many other bigger challenges in ensuring the health and quality of life of their population.

As closing remarks, we believe it is crucial to remember that corporate citizenship and sustainability is about going beyond compliance and integrating social and environmental aspects into business strategies. It is about ethics.

Any company, including oil companies and car & truck manufactures, should at least comply with the law of the country in which they operate. Although Petrobras can be considered as the major cultural sponsor in Brazil, and has been investing large amounts of resources in philanthropy, when it refers to integrating sustainability and ethics into its core business there is still a long journey ahead.

⁷ Opening the Door to Cleaner Vehicles in Developing and Transition Countries: The Role of Lower Sulfur Fuels, United Nations Environment Program – UNEP, 2007

⁸ Global Environment Outlook: environment for development (GEO-4), UNEP, 2007, page 58.