PETROBRAS INTERNATIONAL FINANCE CO
Form 20-F
June 28, 2006

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 20-F
ANNUAL REPORT
PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
for the fiscal year ended December 31, 2005

Commission File Number 1-15106	**Commission File Number: 333-14168**
PETRÓLEO BRASILEIRO S.A. PETROBRAS **(Exact name of registrant as specified in its charter)**	**Petrobras International Finance Company** **(Exact name of registrant as specified in its charter)**
Brazilian Petroleum Corporation PETROBRAS **(Translation of registrant s name into English)**	
The Federative Republic of Brazil **(Jurisdiction of incorporation or organization)**	**Cayman Island** **(Jurisdiction of incorporation or organization)**
Avenida República do Chile, 65 **20031-912 Rio de Janeiro RJ** **Brazil** **(Address of principal executive offices)**	**Harbour Place** **103 South Church Street, 4th floor** **P.O. Box 1034GT BWI** **George Town, Grand Cayman** **Cayman Islands** **(Address of principal executive offices)**

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of each class:	**Name of each exchange on which registered:**
PETROBRAS Common Shares, without par value* PETROBRAS American Depositary Shares (as evidenced by American Depositary Receipts), each representing 4 Common Shares	New York Stock Exchange
PETROBRAS Preferred Shares, without par value* PETROBRAS American Depositary Shares (as evidenced by American Depositary Receipts), each representing 4 Preferred Shares	New York Stock Exchange

* Not for trading, but only in connection with the registration of American Depositary Shares, pursuant to the requirements of the Securities and Exchange Commission.

Securities registered or to be registered pursuant to Section 12(g) of the Act: None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:

Title of each class:

PIFCo U.S.$500,000,000 9.125% Senior Notes due 2007
PIFCo U.S.$450,000,000 9.875% Senior Notes due 2008
PIFCo U.S.$400,000,000 9.00% Global Step-Up Notes due 2008
PIFCo U.S.$600,000,000 9.750% Senior Notes due 2011
PIFCo U.S.$750,000,000 9.125% Global Notes due 2013
PIFCo U.S.$750,000,000 8.375% Global Notes due 2018
PIFCo U.S.$600,000,000 7.75% Global Notes due 2014

Indicate the number of outstanding shares of each of the issuer s classes of capital or common stock as of the close of the period covered by this Annual Report:

At December 31, 2005, there were outstanding:
2,536,673,672 PETROBRAS Common Shares, without par value
1,849,478,028 PETROBRAS Preferred Shares, without par value
50,000 PIFCo Common Shares

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined by Rule 405 of the Securities Act.

Yes þ **No** o

If this report is an annual or transitional report, indicate by check mark if the registrant is not required to file reports pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes o **No** þ

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes þ **No** o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ **Accelerated filer** o **Non-accelerated filer** þ **[PIFCo]** **[Petrobras]**

Indicate by check mark which financial statement item the registrant has elected to follow.

Item 17 o **Item 18** þ

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o **No** þ

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FORWARD-LOOKING STATEMENTS

Many statements made in this annual report are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, that are not based on historical facts and are not assurances of future results. Many of the forward-looking statements contained in this annual report may be identified by the use of forward-looking words, such as believe, expect, anticipate, should, planned, estimate and potential, among others. We have made forward-looking statements tha address, among other things, our:

- regional marketing and expansion strategy;
- drilling and other exploration activities;
- import and export activities;
- projected and targeted capital expenditures and other costs, commitments and revenues;
- liquidity; and
- development of additional revenue sources.

Because these forward-looking statements involve risks and uncertainties, there are important factors that could cause actual results to differ materially from those expressed or implied by these forward-looking statements. These factors include:

- general economic and business conditions, including crude oil and other commodity prices, refining margins and prevailing exchange rates;
- international and Brazilian political, economic and social developments;
- our ability to find, acquire or gain access to additional reserves and to successfully develop our current ones;
- uncertainties inherent in making estimates of our reserves;
- our ability to obtain financing;
- competition;
- technical difficulties in the operation of our equipment and the provision of our services;
- changes in, or failure to comply with, governmental regulations;
- receipt of governmental approvals and licenses;
- military operations, terrorist acts, wars or embargoes;
- the cost and availability of adequate insurance coverage; and
- other factors discussed below under Risk Factors.

These statements are not guarantees of future performance and are subject to certain risks, uncertainties and assumptions that are difficult to predict. Therefore, our actual results could differ materially from those expressed or forecast in any forward-looking statements as a result of a variety of factors, including those in Risk Factors.

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All forward-looking statements are expressly qualified in their entirety by this cautionary statement, and you should not place reliance on any forward-looking statement contained in this annual report.

The crude oil and natural gas reserve data presented or described in this annual report are only estimates and our actual production, revenues and expenditures with respect to our reserves may materially differ from these estimates.

Unless the context otherwise requires, the terms Petrobras , we , us , and our refer to Petróleo Brasileiro S.A.-Petrobras and its consolidated subsidiaries and special purpose companies, including Petrobras International Finance Company. The term PIFCo refers to Petrobras International Finance Company and its subsidiaries.

CERTAIN TERMS AND CONVENTIONS

A glossary of petroleum industry terms, a table of abbreviations and a conversion table are presented beginning on page 204.

PRESENTATION OF FINANCIAL INFORMATION

In this annual report, references to *real*, *reais* or R$ are to Brazilian *reais* and references to U.S. dollars or U.S are to United States dollars. Certain figures included in this annual report have been subject to rounding adjustments; accordingly, figures shown as totals in certain tables may not be an exact arithmetic aggregation of the figures that precede them.

Petrobras

The audited consolidated financial statements of Petrobras and our consolidated subsidiaries as of December 31, 2005 and 2004, and for each of the three years in the period ended December 31, 2005, and the accompanying notes, contained in this annual report have been presented in U.S. dollars and prepared in accordance with U.S. generally accepted accounting principles, or U.S. GAAP. See Item 5. Operating and Financial Review and Prospects and Note 2(a) to our audited consolidated financial statements. We also publish financial statements in Brazil in *reais* in accordance with the accounting principles required by Law No. 6404/76, as amended, or Brazilian Corporation Law and the regulations promulgated by the *Comissão de Valores Mobiliários* (Brazilian Securities Commission, or the CVM), or Brazilian GAAP, which differs in significant respects from U.S. GAAP.

We are required by Brazilian Corporation Law to change auditors every five years and to select auditors through a bidding process authorized by the Board of Directors. From June 2003 through December 31, 2005, Ernst & Young Auditores Independentes S/S served as our independent auditors and audited our financial statements for each of the years ended December 31, 2005, 2004 and 2003. PricewaterhouseCoopers Auditores Independentes audited our financial statements for each of the years ended December 31, 2002 and 2001. As of January 1, 2006, we hired KPMG Auditores Independentes to serve as our independent auditors.

Our functional currency is the Brazilian *real*. As described more fully in Note 2(a) to our audited consolidated financial statements, the U.S. dollar amounts as of the dates and for the periods presented in our audited consolidated financial statements have been remeasured or translated from the *real* amounts in accordance with the criteria set forth in Statement of Financial Accounting Standards No. 52 of the U.S. Financial Accounting Standards Board, or SFAS 52. U.S. dollar amounts presented in this annual report have been translated from *reais* at the period-end exchange rate for balance sheet items and the average exchange rate prevailing during the period for income statement and cash flow items.

Unless the context otherwise indicates,

- historical data contained in this annual report that were not derived from the consolidated financial statements have been translated from *reais* on a similar basis;

forward-looking amounts, including estimated future capital expenditures, have all been based on our 2005-2015 Strategic Plan and 2006-2010 Business Plan and have been projected on a constant basis and have been translated from *reais* in 2006 at an estimated average exchange rate of R$3.01 to U.S.$1.00, and future calculations involving an assumed price of crude oil have been calculated using a Brent crude oil price of U.S.$45.00 per barrel for 2006, and U.S.$30.00 per barrel for 2007 and U.S.$25.00 per barrel for 2008 and thereafter, adjusted for our quality and location differences, unless otherwise stated; and

estimated future capital expenditures are based on the most recently budgeted amounts, which may not have been adjusted to reflect all factors that could affect such amounts.

We signed a final agreement for the acquisition of Petrobras Energía Participaciones S.A., or PEPSA, and Petrolera Entre Lomas S.A., or PELSA, in October 2002 and the acquisition was approved by Argentine government agencies in May 2003. Our results of operations for 2002 do not include PEPSA and PELSA s results and our results of operations for 2003 only include PEPSA and PELSA s results from June through December of 2003. We acquired Liquigás Distribuidora S.A. (formerly Sophia do Brasil S.A. and Agip do Brasil S.A.) in August 2004. Our results of operations for 2004 only include Liquigás Distribuidora s results from August to December of 2004. See Note 20 to our audited consolidated financial statements for further information about these acquisitions.

We adopted FIN 46 in our financial statements for the year ended December 31, 2003. Our interest in certain project finance special purpose entities and gas-fired power plants were consolidated on a line-by-line basis in the income statement beginning as of January 1, 2004. Although this consolidation affected each line of the income statement, it did not have a significant impact on our net income.

PIFCo

PIFCo s functional currency is the U.S. dollar. Substantially all of PIFCo s sales are made in U.S. dollars and all of its debt is denominated in U.S. dollars. Accordingly, PIFCo s audited consolidated financial statements as of December 31, 2005 and 2004, and for each of the three years in the period ended December 31, 2005, and the accompanying notes contained in this annual report have been presented in U.S. dollars and prepared in accordance with U.S. GAAP and include PIFCo s wholly-owned subsidiaries: Petrobras Europe Limited, Petrobras Finance Limited and Bear Insurance Company Limited BEAR

PRESENTATION OF INFORMATION CONCERNING RESERVES

The estimates of our proved reserves of crude oil and natural gas as of December 31, 2005, included in this annual report have been calculated according to the technical definitions required by the U.S. Securities and Exchange Commission, or the SEC. DeGolyer and MacNaughton provided estimates of most of our net domestic reserves as of December 31, 2005. All reserve estimates involve some degree of uncertainty. See Item 3. Key Information Risk Factors Risks Relating to Our Operations for a description of the risks relating to our reserves and our reserve estimates.

We also file oil and gas reserve estimates with governmental authorities in most of the countries in which we operate. On January 16, 2006, we filed reserve estimates for Brazil with the *Agência Nacional de Petróleo* (the National Petroleum Agency, or the ANP), in accordance with Brazilian rules and regulations, totaling 11.36 billion barrels of crude oil and NGLs and 11,206.57 billion cubic feet of natural gas. The reserve estimates we filed with the ANP and those provided herein differ by approximately 25%. This difference is due to (1) the ANP requirement that we estimate proved reserves through the technical abandonment of production wells, as opposed to limiting reserve estimates to the life of our concession contracts as required by Rule 4-10 of Regulation S-X and (2) different technical criteria for booking proved reserves, including the use of 3-D seismic data to establish proved reserves in Brazil.

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We also file reserve estimates from our international operations with various governmental agencies under the guidelines of the Society of Petroleum Engineers, or SPE. The aggregate reserve estimates from our international operations, under SPE guidelines, amounted to 0.96 billion barrels of crude oil and NGLs and 4,355 billion cubic feet of natural gas, which differs by approximately 40 percent from reserve estimates provided herein because the SPE s different technical guidelines allow for (1) the booking of reserves in Bolivia beyond the life of certain gas sale contracts and (2) the booking of reserves in Nigeria based on 3-D seismic data and certain oil recovery techniques, such as fluid injection, without the performance of pilot project tests.

Bolivia and Venezuela announced certain nationalization measures, which we expect will have the effect of reducing our oil and gas reserves in these countries. As a result, the information concerning reserves in Bolivia and Venezuela as provided herein may change. See Item 3. Key Information Risk Factors Risks Relating to Our Operations¾ The recent nationalization measures taken by the Bolivian and Venezuelan governments may have an adverse effect on our results of operations and financial condition.

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

Selected Financial Data

Petrobras

The following table sets forth our selected consolidated financial data, presented in U.S. dollars and prepared in accordance with U.S. GAAP. The data for each of the five years in the period ended December 31, 2005 have been derived from our audited consolidated financial statements, which were audited by Ernst & Young Auditores Independentes S/S for each of the years ended December 31, 2005, 2004 and 2003 and by PricewaterhouseCoopers Auditores Independentes for each of the years ended December 31, 2002 and 2001. The information below should be read in conjunction with, and is qualified in its entirety by reference to, our audited consolidated financial statements and the accompanying notes and Item 5. Operating and Financial Review and Prospects.

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BALANCE SHEET DATA

	As of December 31,				
	2005	2004	2003	2002	2001
	(in millions of U.S. dollars)				
Assets					
Current assets:					
Cash and cash equivalents	$ 9,871	$ 6,856	$ 8,344	$ 3,301	$ 7,360
Accounts receivable, net	6,184	4,285	2,905	2,267	2,759
Inventories	5,305	4,904	2,947	2,540	2,399
Recoverable taxes	2,087	1,475	917	672	664
Advances to suppliers	652	422	504	794	483
Other current assets	1,679	1,484	1,817	748	661
Total current assets	25,778	19,426	17,434	10,322	14,326
Property, plant and equipment, net	45,920	37,020	30,805	18,224	19,179
Investments in non-consolidated companies and other investments	1,810	1,862	1,173	334	499
Other assets:					
Accounts receivables, net	607	411	528	369	476
Advances to suppliers	489	580	416	450	403
Petroleum and Alcohol Account-Receivable from the Brazilian government(1)	329	282	239	182	81
Government securities	364	326	283	176	665
Unrecognized pension obligation				61	187
Restricted deposits for legal proceedings and guarantees	775	699	543	290	337
Recoverable taxes	639	536	467	156	164
Investments PEPSA and PELSA				1,073	
Goodwill	237	211	183		
Prepaid expenses	246	271	190	100	78
Marketable securities	129	313	806	208	212
Fair value asset of gas hedge	547	635			
Others	755	510	545	209	257
Total other assets	5,117	4,774	4,200	3,274	2,860
Total assets	$ 78,625	$ 63,082	$ 53,612	$ 32,154	$ 36,864
Liabilities and Shareholders equity					
Current liabilities:					
Trade accounts payable	$ 3,838	$ 3,284	$ 2,261	$ 1,702	$ 1,783
Taxes payable	3,423	2,569	2,305	1,801	2,145
Short-term debt	950	547	1,329	671	1,101
Current portion of long-term debt	1,428	1,199	1,145	727	940
Current portion of project financings	2,413	1,313	842	239	680
Current portion of capital lease obligations	239	266	378	349	298

Dividends and interest on capital payable	3,068	1,900	1,955	307	93
Payroll and related charges	918	618	581	283	333
Advances from customers	609	290	258	119	26
Employees postretirement benefits obligations Pension	206	166	160	89	117
Other current liabilities	1,063	1,176	823	976	528
Total current liabilities	18,155	13,328	12,037	7,263	8,044
Long-term liabilities:					
Long-term debt	11,503	12,145	11,888	6,987	5,908
Project financings	3,629	4,399	5,066	3,800	3,153
Employees postretirement benefits obligations Pension	3,627	2,915	1,895	1,363	1,971
Employees postretirement benefits obligation Health Care	3,004	2,137	1,580	1,060	1,409
Capital lease obligations	1,015	1,069	1,242	1,907	1,930
Deferred income tax	2,159	1,558	1,122	259	717
Gas-fired power liabilities		1,095	1,142		
Deferred Purchase Incentive	144	153			
Provision for abandonment of wells	842	403	396		
Other liabilities	556	497	541	350	406
Total long-term liabilities	26,479	26,371	24,872	15,726	15,494
Minority interest	1,074	877	367	(136)	79

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	As of December 31,				
	2005	2004	2003	2002	2001
	(in millions of U.S. dollars)				
Shareholders equity					
Shares authorized and issued:					
Preferred share	4,772	4,772	2,973	2,459	1,882
Common share	6,929	6,929	4,289	3,761	2,952
Capital reserve and other comprehensive income	21,216	10,805	9,074	3,081	8,413
Total Shareholders equity	32,917	22,506	16,336	9,301	13,247
Total liabilities and Shareholders equity	$ 78,625	$ 63,082	$ 53,612	$ 32,154	$ 36,864

(1) Prior to July 29, 1998, the Petroleum and Alcohol Account reflected the difference between our actual cost for imported crude oil and oil products and the price set by the Brazilian government, as well as the net effects on us of the administration of certain subsidies and of our fuel alcohol activities. From July 29, 1998 until December 31, 2001, the Petroleum and Alcohol Account was required to be adjusted by the PPE and certain fuel transportation and other reimbursable costs. As from the price deregulation on January 2, 2002, the Petroleum and Alcohol Account

reflected only the outstanding balance owed to us by the Brazilian government and adjustments resulting from monetary correction and audits to the Account. See Item 4. Information on the Company Regulation of the Oil and Gas Industry in Brazil Price Regulation The Petroleum and Alcohol Account.

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INCOME STATEMENT DATA

	For the Year Ended December 31,				
	2005	2004 (11)	2003 (11)	2002(11)	2001(11)
	(in millions of U.S. dollars, except for share and per share data)				
s of products and services	$ 74,065	$ 51,954	$ 42,690	$ 32,987	$ 34,1
ue-added and other taxes on sales and services	(14,694)	(10,906)	(9,527)	(7,739)	(8,6
E(1)	(3,047)	(2,620)	(2,249)	(2,636)	
cific parcel price PPE(2)					(9
operating revenues	$ 56,324	38,428	30,914	22,612	24,5
t of sales(3)	29,828	21,279	15,533	11,506	12,8
reciation, depletion and amortization(4)(12)	2,926	2,481	1,785	1,930	1,7
loration, including exploratory dry holes(4)(5)	1,009	613	512	435	4
ing, general and administrative expenses	4,474	2,901	2,091	1,741	1,7
er operating expense(6)	1,137	572	597	222	2
l costs and expenses	39,374	27,846	20,518	15,834	16,9
ncial income	710	956	634	1,142	1,3
ncial expense	(1,189)	(1,733)	(1,247)	(774)	(8
etary and exchange variation on monetary assets liabilities, net	248	450	509	(2,068)	(9
loyee benefit expense	(994)	(650)	(595)	(451)	(5
er non-operating income (expense), net(7)	(1,133)	(670)	(924)	(1,395)	(1,8
me before income taxes, minority interest, aordinary item and accounting change	14,592	8,935	8,773	3,232	4,7
me tax (expense) benefit:					
rent	(4,223)	(2,114)	(2,599)	(1,269)	(1,1
erred	(218)	(117)	(64)	116	(1
l income tax expense	(4,441)	(2,231)	(2,663)	(1,153)	(1,3
ority interests in results of consolidated idiaries	35	(514)	(248)	232	
me before extraordinary item and effect of ge in accounting principle	10,186	6,190	5,862	2,311	3,4
aordinary gain net of tax	158				
ulative effect of change in accounting principle, of taxes(4)			697		
income for the year	$ 10,344	$ 6,190	$ 6,559	$ 2,311	$ 3,4
ghted average number of shares Outstanding:(8)					
mon(8)	2,536,673,672	2,536,673,672	2,536,673,672	2,536,673,672	2,536,673,6
erred(8)	1,849,478,028	1,849,478,028	1,849,478,028	1,807,742,676	1,807,742,6
c and diluted earnings per share:(8)(9)					

mon and Preferred Shares(8)(9)	$	2.36	$	1.41	$	1.50	$	0.53	$	0
mon and Preferred ADS(8)(9)	$	9.44	$	5.64	$	6.00	$	2.12	$	3
n dividends per(8)(10):										
mon and Preferred shares(8)(10)	$	0.68	$	0.42	$	0.37	$	0.29	$	0
mon and Preferred ADS(8)(10)	$	2.72	$	1.68	$	1.48	$	1.16	$	1

(1) CIDE is a per-transaction tax due to the Brazilian government.

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(2) According to specific legislation applicable to the Petroleum and Alcohol Account through December 31, 2001, the Petroleum and Alcohol Account was realized through collection of the Specific Parcel Price-PPE generated by the sale of the majority of basic oil products (gasoline, diesel oil and LPG). The PPE represented the difference between the selling prices of these products at the refinery (net of *Imposto sobre Circulação de Mercadorias e Serviços* (state value-added tax), or ICMS and other charges levied on sales), fixed in *reais* by the Brazilian Government, and the corresponding realization prices for such products, which is the basis for calculation net operating revenues. The realization prices (PR) for each oil product were determined on the basis of a pricing formula established by the Brazilian Government that, with a lag of approximately one month, reflected

changes in oil products quotations on the international market and the exchange rate. When the invoicing price net of ICMS and PASEP/COFINS exceeded the realization price, the PPE collection was positive and reduced the balance of the Petroleum and Alcohol Account. Conversely, when the invoicing value net of ICMS and PASEP/COFINS was less than the realization price, the PPE collection was negative and increased the balance of the Petroleum and Alcohol Account. See Item 4. Information on the Company Regulation of the Oil and Gas Industry in Brazil Price Regulation The Petroleum and Alcohol Account.

(3) Amounts reported are net of impact of government charges and taxes of U.S.$68 million in 2001. The governmental regulations giving rise to such charges/credits and taxes were abolished in 2002.

(4) In 2002, U.S.$284 million in

abandonment costs were recognized as depreciation, depletion and amortization in accordance with SFAS 19. In 2003, as a result of our adoption of SFAS 143 Accounting for Asset Retirement Obligations, depreciation on the asset retirement obligation was recorded under depreciation, depletion and amortization, while accretion expense was recorded under exploration, including exploratory dry holes. This change resulted in U.S.$43 million in abandonment costs being recognized as exploration, including exploratory dry holes in 2003. The cumulative effect of adoption is recorded separately.

(5) In 2005, we reviewed and revised our estimated costs associated with well abandonment and the demobilization of oil and gas production areas, considering new information about date of expected abandonment and revised cost estimates to

abandon. The changes to estimated asset retirement obligation were principally related to changing expectations about Brent prices, which led the correlated fields to have longer economic lives. This review resulted in a decrease in the related provision of U.S.$21 million with a gain recognized in net income, and recorded in the line titled exploratory costs for oil and gas exploration. See note 2(i) to our audited consolidated financial statements.

(6) Amounts reported are net of impact of government charges and taxes of U.S.$45 million in 2001. The governmental regulations giving rise to such charges and taxes were abolished in 2002.

(7) Amounts reported include financial charges in respect of the Petroleum and Alcohol Account of U.S.$2 million in 2002 and U.S.$16 million in 2001.

(8) On July 22, 2005, our board of directors authorized a 4 for 1 stock split.

For purposes of comparison, the weighted average number of shares outstanding, net income per share/ADS and cash dividends per share/ADS were restated for periods prior to the stock split, which became effective as of September 1, 2005. See note 10 to our audited consolidated financial statements.

(9) Basic and diluted earnings per share for 2003 reflect our adoption of SFAS 143. That change in accounting principle altered our 2003 basic and diluted earnings per share from U.S.$1.34 (before effect of change in accounting principle) to U.S.$ 1.50 (after effect of change in accounting principle). And for 2005, the extraordinary item altered our basic and diluted earnings per share from U.S.$2.32 (before effect of extraordinary item) to U.S.$2.36 (after effect of extraordinary item).

(10) Represents dividends declared in respect of the earnings of each period.

(11)

Certain amounts from prior years have been reclassified to conform to current year presentation standards. These reclassifications had no impact on the Company s net income.

(12) Including in 2005 an impairment charge relating to our operations in Venezuela.

PIFCo

The following table sets forth PIFCo s selected consolidated financial data, presented in U.S. dollars and prepared in accordance with U.S. GAAP. The data for each of the five years in the period ended December 31, 2005 have been derived from PIFCo s audited consolidated financial statements, which were audited by Ernst & Young Auditores Independentes S/S for each of the years ended December 31, 2005, 2004 and 2003 and by PricewaterhouseCoopers Auditores Independentes for each of the years ended December 31, 2002 and 2001. The information below should be read in conjunction with, and is qualified in its entirety by reference to, PIFCo s audited consolidated financial statements and the accompanying notes and Item 5. Operating and Financial Review and Prospects.

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	For the Year Ended December 31,				
	2005	2004	2003	2002	2001
	(in millions of U.S. dollars)				
Income Statement Data:					
Sales of crude oil and oil products and Services:					
Related Parties	$ 13,974.4	$ 10,118.4	$ 5,543.0	$ 5,375.5	$ 5,860.6
Others	3,161.7	2,237.2	1,432.5	1,014.7	399.9
Lease income(1)				36.1	10.7
	$ 17,136.1	$ 12,355.6	$ 6,975.5	$ 6,426.3	$ 6,271.2
Operating Expenses:					
Cost of sales					
Related Parties	(7,780.3)	(4,391.3)	(2,851.4)	(2,409.0)	(1,648.1)
Others	(9,203.0)	(7,844.7)	(4,068.7)	(3,962.5)	(4,604.9)
Lease expense(1)				(24.0)	(10.5)
Selling, general and Administrative expenses					
Related parties	(158.1)	(98.7)	(17.1)		
Others	(7.6)	(1.1)	(1.5)	(1.2)	(0.1)
	(17,149.0)	(12,335.8)	(6,938.7)	(6,396.7)	(6,263.6)
Operating income (loss)	(12.9)	19.8	36.8	29.6	7.6
Financial income(2)					
Related Parties	765.5	568.6	401.7	201.9	155.4
Others	218.5	110.2	41.2	17.7	3.4
Total	984.0	678.8	442.9	219.6	158.8
Financial expense(3)					
Related Parties	(409.8)	(169.0)	(111.9)	(61.3)	(67.4)
Others	(589.1)	(592.2)	(370.8)	(253.4)	(119.7)
Total	(998.9)	(761.2)	(482.7)	(314.7)	(187.1)
Other income, net					
Related Parties		(0.5)			
Others		4.0			0.4
Net loss	$ (27.8)	$ (59.1)	$ (3.0)	$ (65.5)	$ (20.3)
Balance Sheet Data (end of period):					
Cash and cash equivalents	$ 230.7	$ 1,107.3	664.2	260.6	48.6
Trade accounts receivable					
Related parties	8,681.1	7,788.1	5,064.5	4,837.1	2,583.7
Others	212.7	153.6	109.4	57.1	44.7
Notes receivable					
Related parties	3,909.3	1,936.9	1,726.4	1,631.6	283.0

Export Prepayment					
Related parties	943.9	1,414.7	1,479.4	751.2	751.2
Marketable Securities	2,248.6	1,864.8	615.8	96.3	
Total assets	16,748.9	14,670.2	10,196.6	8,697.3	4,277.8
Trade accounts payable					
Related parties	950.7	562.1	271.0	292.0	288.1
Other	616.1	568.1	349.0	281.1	231.0
Notes payable					
Related parties	8,080.3	6,435.0	2,442.8	3,688.2	334.6
Short-term financing and current portion of long-term debt	891.1	680.9	1,076.4	367.5	990.4
Long-term debt(4)	5,908.4	6,151.8	5,825.3	3,850.4	2,335.0
Total stockholders equity	8.0	35.7	94.8	43.9	49.4
Total liabilities and stockholders equity	16,748.9	14,670.2	10,196.6	8,697.3	4,277.8

(1) As a result of PIFCo s transfer of PNBV, its leasing subsidiary, to us in January 2003, PIFCo had no lease income or lease expense in 2003, 2004 and 2005.

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(2) Financial income represents primarily the imputed interest realized from PIFCo s sales of crude oil and oil products to us.

(3) Financial expense consists primarily of costs incurred by PIFCo in financing its activities in connection with the importation by us of crude oil and oil products.

(4) Includes capital lease obligations of U.S.$601.7 million at December 31, 2002.

Exchange Rates

All foreign exchange transactions are now carried out in a single foreign exchange market. Prior to March 14, 2005, there were two principal foreign exchange markets in Brazil, the commercial rate exchange market and the floating rate exchange market. Most trade and financial transactions were carried out on the commercial rate exchange market, including the purchase or sale of our shares or the payment of dividends with respect to our shares to shareholders outside Brazil. Transactions not carried out on the commercial rate exchange market were generally carried out on the floating rate exchange market.

Foreign currencies may only be purchased through Brazilian financial institutions authorized to operate in such market and are subject to registration with the Central Bank electronic system. Foreign exchange rates are freely negotiated, but may be influenced by Central Bank intervention. The Central Bank of Brazil allows the *real*/U.S. dollar exchange rate to float freely, and it has intervened occasionally to control unstable movements in foreign exchange rates. We cannot predict whether the Central Bank or the Brazilian government will continue to let the *real* float freely or will intervene in the exchange rate market through a currency band system or otherwise.

The *real* depreciated 52.3% in 2002 against the U.S. dollar, before appreciating 18.2% in 2003 and continuing to appreciate 8.1% in 2004 and 11.8% in 2005. As of June 21, 2006, the *real* has appreciated to R$2.238 per U.S.$1.00, representing an appreciation of approximately 4.4% in 2006 year-to-date The *real* may depreciate or appreciate substantially in the future. Risk Factors Risks Relating to Brazil.

The following table provides information on the selling exchange rate, expressed in *reais* per U.S. dollar (R$/U.S.$), for the periods indicated. The table uses the commercial selling rate prior to March 14, 2005

	For the Year Ended December 31, (R$ /U.S.$)			
	High	**Low**	**Average (1)**	**Period End**
Year ended December 31,				
2005	2.762	2.163	2.435	2.341
2004	3.205	2.654	2.926	2.654
2003	3.662	2.822	3.075	2.889
2002	3.955	2.271	2.924	3.533
2001	2.835	1.935	2.352	2.320
Month				
November 2005	2.252	2.163	2.211	2.207
December 2005	2.374	2.180	2.286	2.341
January 2006	2.346	2.212	2.273	2.216
February 2006	2.222	2.118	2.159	2.136
March 2006	2.224	2.107	2.148	2.172
April 2006	2.172	2.089	2.131	2.089
May 2006	2.059	2.371	2.170	2.301
June 2006 (through June 21)	2.302	2.238	2.262	2.238

Source: Central Bank of Brazil

(1) Year-end figures stated for calendar years 2005, 2004, 2003, 2002 and 2001 represent the average of the month-end exchange rates during the relevant period. The figures provided for the months of calendar year 2006 and 2005, as well as for the month of June up to and including June 21, 2006, represents the average of the exchange rates at the close of trading on each business day during such

period.

Brazilian law provides that, whenever there is a serious imbalance in Brazil s balance of payments or serious reasons to foresee such an imbalance, temporary restrictions on remittances from Brazil may be imposed by the Brazilian government. These types of measures may be taken by the Brazilian government in the future,

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including measures relating to remittances related to our preferred or common shares or American Depositary Shares, or ADSs. See Risk Factors-Risks Relating to Brazil.

Risk Factors

Risks Relating to Our Operations

Substantial or extended declines in the prices of crude oil and oil products may have a material adverse effect on our income.

The major part of our revenue is derived from sales of crude oil and oil products. We do not, and will not, have control over the factors affecting international prices for crude oil and oil products. The average prices of Brent crude, an international benchmark oil, were approximately U.S.$ 54.38 per barrel for 2005, U.S.$38.21 per barrel for 2004 and U.S.$28.84 per barrel for 2003. Changes in crude oil prices typically result in changes in prices for oil products.

Historically, international prices for crude oil and oil products have fluctuated widely as a result of many factors. These factors include:

- global and regional economic and political developments in crude oil producing regions, particularly in the Middle East;
- the ability of the Organization of Petroleum Exporting Countries (OPEC) and other crude oil producing nations to set and maintain crude oil production levels and prices;
- global and regional supply and demand for crude oil and oil products;
- competition from other energy sources;
- domestic and foreign government regulations;
- weather conditions; and
- global conflicts and acts of terrorism.

Volatility and uncertainty in international prices for crude oil and oil products may continue. Substantial or extended declines in international crude oil prices may have a material adverse effect on our business, results of operations and financial condition, and the value of our proved reserves. In addition, significant decreases in the price of crude oil may cause us to reduce or alter the timing of our capital expenditures, and this could adversely affect our production forecasts in the medium term and our reserve estimates in the future.

Our ability to achieve our growth objectives depends on our ability to discover additional reserves and successfully develop them, and failure to do so could prevent us from achieving our long-term goals for growth in production.

Our ability to achieve our growth objectives is highly dependent upon our ability to discover additional reserves, as well as to successfully develop our current reserves. In addition, our exploration activities expose us to the inherent risks of drilling, including the risk that we will not discover commercially productive crude oil or natural gas reserves. The costs of drilling wells are often uncertain, and numerous factors beyond our control (such as unexpected drilling conditions, equipment failures or accidents and shortages or delays in the availability of drilling rigs and the delivery of equipment) may cause drilling operations to be curtailed, delayed or cancelled. These risks are heightened when we drill in deep water (between 300 and 1,500 meters water depth) and ultra deep water (more than 1,500 meters). Deep water drilling represented approximately 36% of the exploratory wells we drilled in 2005, a higher proportion than for many other oil and gas producers.

Unless we conduct successful exploration and development activities or acquire properties containing proved reserves, or both, our proved reserves will decline as reserves are extracted. If we fail to gain access to additional reserves we may not achieve our long-term goals for production growth and our results of operations and financial condition may be adversely affected.

Our crude oil and natural gas reserve estimates involve some degree of uncertainty, which could adversely affect our ability to generate income.

The proved crude oil and natural gas reserves set forth in this annual report are our estimated quantities of crude oil, natural gas and natural gas liquids that geological and engineering data demonstrate with reasonable certainty to be recoverable from known reservoirs under existing economic and operating conditions (i.e., prices and costs as of the date the estimate is made). Our proved developed crude oil and natural gas reserves are reserves that can be expected to be recovered through existing wells with existing equipment and operating methods. There are uncertainties in estimating quantities of proved reserves related to prevailing crude oil and natural gas prices applicable to our production, which may lead us to make revisions to our reserve estimates. Downward revisions in our reserve estimates could lead to lower future production, which could have an adverse effect on our results of operations and financial condition.

We are subject to numerous environmental and health regulations that have become more stringent in the recent past and may result in increased liabilities and increased capital expenditures.

Our activities are subject to a wide variety of federal, state and local laws, regulations and permit requirements relating to the protection of human health and the environment, both in Brazil and in other jurisdictions in which we operate. In Brazil, we could be exposed to administrative and criminal sanctions, including warnings, fines and closure orders, for non-compliance with these environmental regulations, which, among other things, limit or prohibit emissions or spills of toxic substances produced in connection with our operations. In 2005, we experienced spills totaling 71,141 gallons of crude oil, as compared to 140,000 gallons in 2004 and 73,000 gallons in 2003. As a result of certain of these spills, we were fined by various state and federal environmental agencies, named the defendant in several civil and criminal suits and remain subject to several investigations and potential civil and criminal liabilities. See Item 8. Financial Information Legal Proceedings. Waste disposal and emissions regulations may require us to clean up or retrofit our facilities at substantial cost and could result in substantial liabilities. The *Instituto Brasileiro do Meio Ambiente e dos Recursos Naturais Renováveis* (Brazilian Institute of the Environment and Renewable Natural Resources, or IBAMA) routinely inspects our oil platforms in the Campos Basin, and may impose fines, restrictions on operations or other sanctions in connection with its inspections. In addition, we are subject to environmental laws that require us to incur significant costs to remedy any damage that a project may cause to the environment (*environmental compensation*). These additional costs may have a negative impact on the profitability of the projects we intend to implement or may make such projects economically unfeasible.

As environmental regulations become more stringent, it is probable that our capital expenditures for compliance with environmental regulations and to effect improvements in our health, safety and environmental practices will increase substantially in the future. Because our capital expenditures are subject to approval by the Brazilian government, increased expenditures to comply with environmental regulations could result in reductions in other strategic investments. Any such reduction may have a material adverse effect on our results of operations or financial condition.

We may incur losses and spend time and money defending pending litigation and arbitration.

We are currently a party to numerous legal proceedings relating to civil, administrative, environmental, labor and tax claims filed against us. These claims involve substantial amounts of money and other remedies. Several individual disputes account for a significant part of the total amount of claims against us. For example, on the grounds that drilling and production platforms may not be classified as sea-going vessels, the Brazilian Revenue Service asserted that overseas remittances for charter payments should be reclassified as lease payment and subject to a withholding tax of 25%. They have filed two tax assessments against us in the aggregate amount of R$3,157 million (approximately U.S.$1,098 million). See Item 8. Financial Information Legal Proceedings.

We may also be subject to labor litigation in connection with recent changes in Brazilian laws relating to retirement benefits affecting our employees.

In the event that claims involving a material amount and for which we have no provisions were to be decided against us, or in the event that the losses estimated turn out to be significantly higher than the provisions made, the aggregate cost of unfavorable decisions could have a material adverse effect on our financial condition and results of operations. Additionally, our management may be required to direct its time and attention to defending these claims, which could preclude them from focusing on our core business. Depending on the outcome, certain litigation could result in restrictions on our operations and have a material adverse effect on certain of our businesses.

If the State of Rio de Janeiro enforces a law imposing ICMS on oil upstream activities, our results of operations and financial condition may be adversely affected.

In June 2003, the State of Rio de Janeiro enacted a law, referred to as Noel Law, imposing ICMS on upstream activities. The constitutionality of the Noel Law is currently being challenged in the Brazilian Supreme Court (*Supremo Tribunal Federal*, or STF) and although the law is technically in force, the government of the State of Rio de Janeiro has not yet enforced it. Currently, the ICMS for fuels derived from oil is assessed at the point of sale but not at the wellhead level. If the State of Rio de Janeiro enforces the Noel Law, it is unlikely (depending on the grounds of the Supreme Court s decision) that the other states would allow us to use the tax imposed at the wellhead level in Rio de Janeiro as a credit to offset the tax imposed at the sale level. Therefore, we would have to pay ICMS at both levels. We estimate that the amount of ICMS that we would be required to pay to the State of Rio de Janeiro could increase by approximately R$8.51 billion (U.S.$3.52 billion) per year. This increase could have a material adverse effect on our results of operations and financial condition.

Our participation in the domestic power market has generated losses and may not become profitable.

Consistent with the global trend of other major oil and gas companies and to secure demand for our natural gas, we participate in the domestic power market. Despite a number of incentives introduced by the Brazilian government to promote the development of gas-fired power plants, development of such plants has been slow due to the market structure and regulation of the power industry, among other things. We have invested, alone or with other investors, in fourteen (twelve in operation and two under construction or development) of the 39 gas-fired power generation plants. Demand for energy produced by our gas-fired power plants has been lower than we expected mainly as a result of good hydrological conditions in the last years that increased the supply and lowered the prices of energy from hydroelectric power plants. The main risks associated with our gas-fired power business are:

- Physical demand for our installed capacity, which is influenced by the current and expected market prices of natural gas;
- The potential mismatch between contracted price indexation for energy to be sold by gas-fired power companies and the cost of natural gas or other substitute fuel supply; and
- The dependence on construction of pipelines and other infrastructure to transport and produce natural gas and the commitment to purchase firm quantities of natural gas to satisfy the requirement of the new regulatory model for power generation in order to sell under long term energy contracts.

As a result of the foregoing, our participation in the domestic power market has generated losses and may not become profitable.

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We may not be able to obtain financing for all of our planned investments, and failure to do so could adversely affect our operating results and financial condition.

The Brazilian government maintains control over our budget and establishes limits on our investments and long-term debt. As a state-controlled entity, we must submit our proposed annual budgets to the Ministry of Planning, Budget and Management, the Ministry of Mines and Energy, and the Brazilian Congress for approval. If we cannot obtain financing that does not require Brazilian government approval, such as structured financings, we may not be free to make all the investments we envision, including those we have agreed to make to expand and develop our crude oil and natural gas fields. If we are unable to make these investments, our operating results and financial condition may be adversely affected.

Currency fluctuations could have a material adverse effect on our financial condition and results of operations, because most of our revenues are in reais and a large portion of our liabilities are in foreign currencies.

The principal market for our products is Brazil, and over the last three fiscal years over 78% of our revenues have been denominated in *reais*. A substantial portion of our indebtedness and some of our operating expenses and capital expenditures are, and are expected to continue to be, denominated in or indexed to U.S. dollars and other foreign currencies. In addition, during 2005 we imported U.S.$8.1 billion of crude oil and oil products, the prices of which were all denominated in U.S. dollars.

The *real* depreciated 52.3% in 2002 against the U.S. dollar before appreciating 18.2%, 8.1% and 11.8% against the U.S. dollar in 2003, 2004 and 2005, respectively. As of June 21, 2006, the exchange rate of the *real* to the U.S. dollar was R$2.238 per U.S.$1.00, representing an appreciation of approximately 4.4% in 2006 year-to-date. The value of the *real* in relation to the U.S. dollar may continue to fluctuate and may include a significant depreciation of the *real* against the U.S. dollar as occurred in 2002. Any future substantial depreciation of the *real* may adversely affect our operating cash flows and our ability to meet our foreign currency-denominated obligations.

We are exposed to increases in prevailing market interest rates, which leaves us vulnerable to increased financing expenses.

As of December 31, 2005, approximately 52.5% of our total indebtedness consisted of floating rate debt. We have not entered into derivative contracts or made other arrangements to hedge against interest rate risk. Accordingly, if market interest rates (principally LIBOR) rise, our financing expenses will increase, which could have an adverse effect on our results of operations and financial condition.

We are not insured against business interruption for our Brazilian operations and most of our assets are not insured against war and terrorism.

We do not maintain coverage for business interruption for our Brazilian operations. If, for instance, our workers were to strike, the resulting work stoppages could have an adverse effect on us, as we do not carry insurance for losses incurred as a result of business interruptions of any nature, including business interruptions caused by labor action. In addition, we do not insure most of our assets against war and terrorism. A terrorist attack or an operational incident causing an interruption of our business could therefore have a material adverse effect on our financial condition or results of operations.

We are subject to substantial risks relating to our international operations, in particular in Latin America and the Middle East.

We operate in a number of different countries, particularly in Latin America, West Africa and the Middle East that can be politically, economically and socially unstable. The results of operations and financial condition of our subsidiaries in these countries may be adversely affected by fluctuations in their local economies, political instability and governmental actions relating to the economy, including:

- the imposition of exchange or price controls;

the imposition of restrictions on hydrocarbon exports;

the depreciation of local currencies;

the nationalization of oil and gas reserves; or

increases in export tax / income tax rates for crude oil and oil products.

If one or more of the risks described above were to materialize we may not achieve our strategic objectives in these countries or in our international operations as a whole, which may result in a material adverse effect on our results of operations and financial condition.

Of the countries outside of Brazil in which we operate, Argentina is the most significant, representing approximately 40% of our total international crude oil and natural gas production and 28% of our international proved crude oil and natural gas reserves at December 31, 2005. In response to the Argentine crisis, the Argentine government has made a number of changes in the regulatory structure of the electricity and gas sectors and has fixed export tax rates for crude oil, natural gas and oil products. We also have significant operations in Bolivia and Venezuela that represented, respectively, approximately 21% and 18% of our total international production in barrels of oil equivalent and 27% and 22% of our international proved crude oil and natural gas reserves at December 31, 2005. Both Bolivia and Venezuela have recently announced certain nationalization measures that may generate material losses to us. At present, there is much uncertainty in the political, economic and social situations, generally in these two countries. See Item 3. Key Information Risk Factors Risks Relating to Our Operations The recent nationalization measures taken by the Bolivian and Venezuelan governments may have an adverse effect on our results of operations and financial condition for a description of the risks associated with these nationalization measures. Deterioration of the situation in Argentina, Bolivia or Venezuela may have an adverse effect on our results of operations and financial condition.

The recent nationalization measures taken by the Bolivian and Venezuelan governments may have an adverse effect on our results of operations and financial condition.

The Bolivian and Venezuelan governments have recently increased their participation in their respective domestic oil and gas industries, which may generate material losses to us.

Our consolidated interests related to Bolivia include two refineries, oil and gas reserves, which represented approximately 2.7% of our total reserves at December 31, 2005 and our interest in the Bolivia-Brazil gas pipeline (GTB). We also hold a long-term gas supply agreement, or the GSA, for the purchase of natural gas from the Bolivian state oil company, Yacimientos Petrolíferos Fiscales Bolivianos YPFB. We have been operating in Bolivia since 1996. As of December 31, 2005, the book value of Bolivia assets were U.S.$990million. On May 1, 2006, the Bolivian government announced that it would nationalize several industries in the country, including the oil and gas industry. As a result, our interest in the two refineries and the oil and gas reserves in Bolivia will be reduced. We have 180 days to comply with the terms and conditions of the nationalization, and it is uncertain if and how we will be compensated for our losses. In 2005, the natural gas we imported from Bolivia represented approximately 53% of our total natural gas sales. We supply this natural gas to the Brazilian market, including local distribution companies and gas-fired power plants in which we have an interest.

Our interests in Venezuela include oil and gas reserves, which represented approximately 2.3% of our total reserves at December 31, 2005. In April 2005, the Venezuelan Energy and Oil Ministry instructed PDVSA to review thirty-two operating agreements signed by PDVSA with oil companies from 1992 through 1997. In addition, PDVSA was instructed to take measures in order to convert all effective operating agreements into state-controlled companies in order to grant the Venezuelan government, through PDVSA, more than 50% ownership of each field, including agreements with our affiliates in connection with the areas of Oritupano Leona, La Concepcion, Acema and Mata. As a result, as of December 31, 2005, we recorded an impairment charge in order to adjust the book value of our Venezuelan assets in the amount of U.S.$134 million. In March 31, 2006, we, Petróleos de Venezuela S.A. (PDVSA) and Corporación Venezolana del Petróleo S.A. (CVP), entered into memorandums of understanding (MOUs) in order to effect the migration of the operating agreements to partially state-owned companies (mixed

companies), whereby the interest of PDVSA in each mixed company will be 60%. The economic effects of the migration are effective since April 1, 2006. See Item 4. Information on the Company International Venezuelan Operations.

As a result of the foregoing, we currently cannot estimate the degree to which these nationalization measures will affect us, and believe they may have a material adverse effect on our results of operations and financial condition.

Risks Relating to PIFCo

PIFCo may not earn enough money from its own operations to meet its debt obligations.

PIFCo is a direct wholly-owned subsidiary of Petrobras incorporated in the Cayman Islands as an exempted company with limited liability. Accordingly, PIFCo s financial position and results of operations are largely affected by our decisions, as its parent company. PIFCo has limited operations consisting principally of the purchase of crude oil and oil products from third parties and the resale of those products to us, with financing for such operations provided by us as well as third-party credit providers. PIFCo also buys and sells crude oil and oil products from and to us, third parties and affiliates on a limited basis. PIFCo s ability to pay interest, principal and other amounts due on its outstanding and future debt obligations will depend upon a number of factors, including:

- our financial condition and results of operations;
- the extent to which we continue to use PIFCo s services for market purchases of crude oil and oil products;
- our willingness to continue to make loans to PIFCo and provide PIFCo with other types of financial support;
- PIFCo s ability to access financing sources, including the international capital markets and third-party credit facilities; and
- PIFCo s ability to transfer its financing costs to us.

In the event of a material adverse change in our financial condition or results of operations or in our financial support of PIFCo, PIFCo may not have sufficient funds to repay all amounts due on its indebtedness. See Risks Relating to Our Operations for a more detailed description of certain risks that may have a material adverse impact on our financial condition or results of operations and therefore affect PIFCo s ability to meet its debt obligations.

If Brazilian law restricts us from paying PIFCo in U.S. dollars, PIFCo may have insufficient U.S. dollar funds to make payments on its debt obligations.

PIFCo obtains substantially all of its funds from our payments in U.S. dollars for crude oil that we purchase from PIFCo. In order to remit U.S. dollars to PIFCo, we must comply with Brazilian foreign exchange control regulations, including preparing specified documentation to be able to obtain U.S. dollar funds for payment to PIFCo. If Brazilian law were to impose additional restrictions, limitations or prohibitions on our ability to convert *reais* into U.S. dollars, PIFCo may not have sufficient U.S. dollar funds available to make payment on its debt obligations. Such restrictions could also have a material adverse effect on the Brazilian economy or our business, financial condition and results of operations.

PIFCo may be limited in its ability to pass on its financing costs.

PIFCo is principally engaged in the purchase of crude oil and oil products for sale to Petrobras, as described above. PIFCo regularly incurs indebtedness related to such purchases and/or obtain financing from us or

third-party creditors. At December 31, 2005, approximately 20% of PIFCo s indebtedness was floating-rate debt denominated in U.S. dollars. All such indebtedness has the benefit of our standby purchase obligation or other support. PIFCo has historically passed on its financing costs to us by selling crude oil and oil products to us at a premium to compensate for its financing costs. Although we intend to continue this practice in the future, we cannot assure you that we will. PIFCo s inability to transfer its financing costs to us could have a material adverse effect on PIFCo s business and on its ability to meet its debt obligations in the long term.

Risks Relating to the Relationship between us and the Brazilian Government

The Brazilian government, as our controlling shareholder, may cause us to pursue certain macroeconomic and social objectives that may have an adverse effect on our results of operations and financial condition.

The Brazilian government, as our controlling shareholder, has pursued, and may pursue in the future, certain of its macroeconomic and social objectives through us. Brazilian law requires the Brazilian government to own a majority of our voting stock, and so long as it does, the Brazilian government will have the power to elect a majority of the members of our board of directors and, through them, a majority of the executive officers who are responsible for our day-to-day management. As a result, we may engage in activities that give preference to the objectives of the Brazilian government rather than to our own economic and business objectives. In particular, we continue to assist the Brazilian government to ensure that the supply of crude oil and oil products in Brazil meets Brazilian consumption requirements. Accordingly, we may make investments, incur costs and engage in sales on terms that may have an adverse effect on our results of operations and financial condition.

If the Brazilian government reinstates controls over the prices we can charge for crude oil and oil products, such price controls could affect our financial condition and results of operations.

In the past, the Brazilian government set prices for crude oil and oil products in Brazil, often below prices prevailing in the world oil markets. These prices involved elements of cross-subsidy among different oil products sold in various regions in Brazil. The cumulative impact of this price regulation system on us is recorded as an asset on our balance sheet under the line item Petroleum and Alcohol Account Receivable from the Brazilian government. The balance of the account at December 31, 2005 was U.S.$329 million. All price controls for crude oil and oil products ended on January 2, 2002, however, the Brazilian government could decide to reinstate price controls in the future as a result of market instability or other conditions. If this were to occur, our financial condition and results of operations could be adversely affected.

We do not own any of the crude oil and natural gas reserves in Brazil.

A guaranteed source of crude oil and natural gas reserves is essential to an oil and gas company s sustained production and generation of income. Under Brazilian law, the Brazilian government owns all crude oil and natural gas reserves in Brazil and the concessionaire owns the oil and gas it produces. We possess the exclusive right to develop our reserves pursuant to concession agreements awarded to us by the Brazilian government and we own the goods we produce under the concession agreements, but if the Brazilian government were to restrict or prevent us from exploiting these crude oil and natural gas reserves, our ability to generate income would be adversely affected.

Risks Relating to Brazil

The Brazilian government has historically exercised, and continues to exercise, significant influence over the Brazilian economy. Brazilian political and economic conditions have a direct impact on our business and may have a material adverse effect on our results of operations and financial condition.

The Brazilian government s economic policies may have important effects on Brazilian companies, including us, and on market conditions and prices of Brazilian securities. Our financial condition and results of operations may be adversely affected by the following factors and the Brazilian government s response to these factors:

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- devaluations and other exchange rate movements;
- inflation;
- exchange control policies;
- social instability;
- price instability;
- energy shortages;
- interest rates;
- liquidity of domestic capital and lending markets;
- tax policy; and
- other political, diplomatic, social and economic developments in or affecting Brazil.

Political instability may adversely affect our results of operations and the price of our securities.

The performance of the Brazilian economy has historically been influenced by the domestic political scenario. Political crises have, in the past, affected the confidence of investors and of the general public and resulted in economic slowdowns, adversely affecting the market price of the shares of publicly-listed companies.

The Brazilian Congress is currently conducting investigations on, among other matters, allegations related to contributions to political campaigns that were unaccounted for or not publicly disclosed, including contributions made to various important members of the current federal administration. Such allegations have resulted in the replacement of key ministers and occupied most of Congress agenda. In addition, some allegations implicated other companies controlled by the Brazilian government. If these investigations were to impact the confidence of the general public and/or of investors, or result in an economic slowdown in Brazil, our results of operations and the price of our shares could be adversely affected.

Additionally, presidential elections in Brazil will take place in 2006 and we cannot assure you that the next administration will maintain the economic policies that were adopted by the current administration. The uncertainties relating to the election may impact the confidence of the general public and of investors and the price of our securities may be adversely affected.

Inflation and government measures to curb inflation may contribute significantly to economic uncertainty in Brazil and to heightened volatility in the Brazilian securities markets and, consequently, may adversely affect the market value of our securities and financial condition.

Our principal market is Brazil, which has, in the past, periodically experienced extremely high rates of inflation. Inflation, along with governmental measures to combat inflation and public speculation about possible future measures, has had significant negative effects on the Brazilian economy. The annual rates of inflation, as measured by the National Wide Consumer Price Index (*Índice Nacional de Preços ao Consumidor Amplo*, or IPCA), have decreased from 2,477.15% in 1993 to 916.46% in 1994 and to 5.97% in 2000. The same index increased to 9.30% in 2003, before decreasing to 7.60% in 2004 and to 5.69% in 2005. Considering the historically high rates of inflation, Brazil may experience higher levels of inflation in the future. The lower levels of inflation experienced since 1995 may not continue. Future governmental actions, including actions to adjust the value of the *real*, could trigger increases in inflation, which may adversely affect our financial condition.

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Access to international capital markets for Brazilian companies is influenced by the perception of risk in Brazil and other emerging economies, which may hurt our ability to finance our operations and the trading values of our securities.

International investors generally consider Brazil to be an emerging market. As a result, economic and market conditions in other emerging market countries, especially those in Latin America, influence the market for securities issued by Brazilian companies. As a result of economic problems in various emerging market countries in recent years (such as the Asian financial crisis of 1997, the Russian financial crisis in 1998 and the Argentine financial crisis that began in 2001), investors have viewed investments in emerging markets with heightened caution. These crises produced a significant outflow of U.S. dollars from Brazil, causing Brazilian companies to face higher costs for raising funds, both domestically and abroad, and impeding access to international capital markets. Increased volatility in securities markets in Latin American and in other emerging market countries may have a negative impact on the trading value of our securities. We cannot assure you that international capital markets will remain open to Brazilian companies or that prevailing interest rates in these markets will be advantageous to us.

Risks Relating to our Equity and Debt Securities

The Brazilian securities markets are smaller, more volatile and less liquid than the major U.S. and European securities markets and therefore you may have greater difficulty selling the common or preferred shares underlying our ADSs

The Brazilian securities markets are smaller, more volatile and less liquid than the major securities markets in the United States and other jurisdictions, and are not as highly regulated or supervised. The relatively small capitalization and liquidity of the Brazilian equity markets may substantially limit your ability to sell the common or preferred shares underlying our ADSs at the price and time you desire. These markets may also be substantially affected by economic circumstances unique to Brazil, such as currency devaluations.

The market for PIFCo s notes may not be liquid.

PIFCo s notes are not listed on any securities exchange and are not quoted through an automated quotation system. We can make no assurance as to the liquidity of or trading markets for PIFCo s notes. We cannot guarantee that the holders of PIFCo s notes will be able to sell their notes in the future. If a market for PIFCo s notes does not develop, holders of PIFCo s notes may not be able to resell the notes for an extended period of time, if at all.

You may be unable to exercise preemptive rights with respect to the common or preferred shares underlying the ADSs.

Holders of ADSs that are residents of the United States may not be able to exercise the preemptive rights relating to the common or preferred shares underlying our ADSs unless a registration statement under the U.S. Securities Act of 1933 is effective with respect to those rights or an exemption from the registration requirements of the Securities Act is available. We are not obligated to file a registration statement with respect to the common or preferred shares relating to these preemptive rights, and therefore we may not file any such registration statement. If a registration statement is not filed and an exemption from registration does not exist, Citibank N.A., as depositary, will attempt to sell the preemptive rights, and you will be entitled to receive the proceeds of the sale. However, the preemptive rights will expire if the depositary cannot sell them. For a more complete description of preemptive rights with respect to the common or preferred shares, see Item 10. Additional Information Memorandum and Articles of Association of Petrobras Preemptive Rights.

You may not be able to sell your ADSs at the time or the price you desire because an active or liquid market for our ADSs may not be sustained.

Our preferred ADSs have been listed on the New York Stock Exchange since February 21, 2001, while our common ADSs have been listed on the New York Stock Exchange since August 7, 2000. We cannot predict whether an active liquid public trading market for our ADSs will be sustained on the New York Stock Exchange, where they are currently traded. Active, liquid trading markets generally result in lower price volatility and more efficient

execution of buy and sell orders for investors. Liquidity of a securities market is often a function of the volume of the underlying shares that are publicly held by unrelated parties. We do not anticipate that a public market for our common or preferred shares will develop in the United States.

Restrictions on the movement of capital out of Brazil may impair your ability to receive dividends and distributions on, and the proceeds of any sale of, the common or preferred shares underlying the ADSs and may impact our ability to service certain debt obligations, including standby purchase agreements we have entered into in support of PIFCo s notes.

The Brazilian government may impose temporary restrictions on the conversion of Brazilian currency into foreign currencies and on the remittance to foreign investors of proceeds from their investments in Brazil. Brazilian law permits the Brazilian government to impose these restrictions whenever there is a serious imbalance in Brazil s balance of payments or there are reasons to foresee a serious imbalance.

The Brazilian government imposed remittance restrictions for approximately six months in 1990. Similar restrictions, if imposed, could impair or prevent the conversion of dividends, distributions, or the proceeds from any sale of common or preferred shares from *reais* into U.S. dollars and the remittance of the U.S. dollars abroad. The Brazilian government could decide to take similar measures in the future. In such a case, the depositary for the ADSs will hold the *reais* it cannot convert for the account of the ADS holders who have not been paid. The depositary will not invest the *reais* and will not be liable for the interest.

Additionally, if the Brazilian government were to impose restrictions on our ability to convert *reais* into U.S. dollars, we would not be able to make payment on our dollar-denominated debt obligations. For example, any such restrictions could prevent us from making funds available to PIFCo, for payment of its debt obligations, certain of which are supported by us through standby purchase agreements.

If you exchange your ADSs for common or preferred shares, you risk losing the ability to remit foreign currency abroad and forfeiting Brazilian tax advantages .

The Brazilian custodian for our common or preferred shares underlying our ADSs must obtain a certificate of registration from the Central Bank of Brazil to be entitled to remit U.S. dollars abroad for payments of dividends and other distributions relating to our preferred and common shares or upon the disposition of the common or preferred shares. If you decide to exchange your ADSs for the underlying common or preferred shares, you will be entitled to continue to rely, for five Brazilian business days from the date of exchange, on the custodian s certificate of registration. After that period, you may not be able to obtain and remit U.S. dollars abroad upon the disposition of the common or preferred shares, or distributions relating to the common or preferred shares, unless you obtain your own certificate of registration or register under Resolution No. 2,689, of January 26, 2000, of the *Conselho Monetário Nacional* (National Monetary Council), which entitles registered foreign investors to buy and sell on the São Paulo Stock Exchange. In addition, if you do not obtain a certificate of registration or register under Resolution No. 2,689, you may be subject to less favorable tax treatment on gains with respect to the common or preferred shares.

If you attempt to obtain your own certificate of registration, you may incur expenses or suffer delays in the application process, which could delay your ability to receive dividends or distributions relating to the common or preferred shares or the return of your capital in a timely manner. The custodian s certificate of registration or any foreign capital registration obtained by you may be affected by future legislative or regulatory changes and we cannot assure you that additional restrictions applicable to you, the disposition of the underlying common or preferred shares or the repatriation of the proceeds from disposition will not be imposed in the future.

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You may face difficulties in protecting your interests as a shareholder because we are subject to different corporate rules and regulations as a Brazilian company and because holders of our common shares, preferred shares and ADSs have fewer and less well-defined shareholders rights than those traditionally enjoyed by United States shareholders.

Our corporate affairs are governed by our bylaws and the Brazilian Corporation Law, which differ from the legal principles that would apply if we were incorporated in a jurisdiction in the United States, such as the States of Delaware or New York, or in other jurisdictions outside Brazil. In addition, your rights as an ADS holder, which are derivative of the rights of holders of our common or preferred shares, as the case may be, to protect your interests against actions by our board of directors may be fewer and less well-defined under Brazilian Corporation Law than those under the laws of other jurisdictions.

Although insider trading and price manipulation are considered crimes under Brazilian law, the Brazilian securities markets are not as highly regulated and supervised as the U.S. securities markets or markets in some other jurisdictions. In addition, rules and policies against self-dealing and the preservation of shareholder interests may be less well-defined and enforced in Brazil than in the United States, putting holders of our common shares, preferred shares and ADSs at a potential disadvantage. Corporate disclosure may be less complete or informative than what may be expected of a U.S. public company.

We are a state-controlled company organized under the laws of Brazil and all of our directors and officers reside in Brazil. Substantially all of our assets and those of our directors and officers are located in Brazil. As a result, it may not be possible for you to effect service of process upon us or our directors and officers within the United States or other jurisdictions outside Brazil or to enforce against us or our directors and officers judgments obtained in the United States or other jurisdictions outside Brazil. Because judgments of U.S. courts for civil liabilities based upon the U.S. federal securities laws may only be enforced in Brazil if certain requirements are met, you may face greater difficulties in protecting your interest in actions against us or our directors and officers than would shareholders of a corporation incorporated in a state or other jurisdiction of the United States.

Preferred shares and the ADSs representing preferred shares generally do not give you voting rights.

A portion of our ADSs represents our preferred shares. Under Brazilian law and our bylaws, holders of preferred shares generally do not have the right to vote in meetings of our stockholders. This means, among other things, that holders of ADSs representing preferred shares are not entitled to vote on important corporate transactions or decisions. See Item 10. Additional Information Memorandum and Articles of Incorporation of Petrobras Voting Rights for a discussion of the limited voting rights of our preferred shares.

Enforcement of our obligations under the standby purchase agreement might take longer than expected.

We have entered into standby purchase agreements in support of PIFCo s obligations under its notes and indentures. Our obligation to purchase from the PIFCo noteholders any unpaid amounts of principal, interest and other amounts due under the PIFCo notes and the indenture applies, subject to certain limitations, irrespective of whether any such amounts are due at maturity of the PIFCo notes or otherwise. See Additional Information PIFCo Senior Notes Standby Purchase Agreements and Additional Information PIFCo Global Notes Standby Purchase Agreements.

We have been advised by our counsel that the enforcement of the standby purchase agreement in Brazil against us, if necessary, will occur under a form of judicial process that, while similar, has certain procedural differences from those applicable to enforcement of a guarantee and, as a result, the enforcement of the standby purchase agreement may take longer than would otherwise be the case with a guarantee.

We may not be able to pay our obligations under the standby purchase agreement in U.S. Dollars.

Payments by us to PIFCo for the import of oil, the expected source of PIFCo s cash resources to pay its obligations under the PIFCo notes, will not require approval by or registration with the Central Bank of Brazil. There may be other regulatory requirements that we will need to comply with in order to make funds available to

PIFCo. If we are required to make payments under the standby purchase agreement, Central Bank of Brazil approval will be necessary. Any approval from the Central Bank of Brazil may only be requested when such payment is to be remitted abroad by us, and will be granted by the Central Bank of Brazil on a case-by-case basis. It is not certain that any such approvals will be obtainable at a future date. In case the PIFCo noteholders receive payments in *reais* corresponding to the equivalent U.S. Dollar amounts due under PIFCo s notes, it may not be possible to convert these amounts into U.S. Dollars. We will not need any prior or subsequent approval from the Central Bank of Brazil to use funds we hold abroad to comply with our obligations under the standby purchase agreement.

We would be required to pay judgments of Brazilian courts enforcing our obligations under the standby purchase agreement only in reais.

If proceedings were brought in Brazil seeking to enforce our obligations in respect of the standby purchase agreement, we would be required to discharge our obligations only in *reais*. Under the Brazilian exchange control limitations, an obligation to pay amounts denominated in a currency other than *reais*, which is payable in Brazil pursuant to a decision of a Brazilian court, may be satisfied in *reais* at the rate of exchange, as determined by the Central Bank of Brazil, in effect on the date of payment.

A finding that we are subject to U.S. bankruptcy laws and that the standby purchase agreement executed by us was a fraudulent conveyance could result in PIFCo noteholders losing their legal claim against us.

PIFCo s obligation to make payments on the PIFCo notes is supported by our obligation under the standby purchase agreement to make payments on PIFCo s behalf. We have been advised by our external U.S. counsel that the standby purchase agreement is valid and enforceable in accordance with the laws of the State of New York and the United States. In addition, we have been advised by our general counsel that the laws of Brazil do not prevent the standby purchase agreement from being valid, binding and enforceable against us in accordance with its terms. In the event that U.S. federal fraudulent conveyance or similar laws are applied to the standby purchase agreement, and we, at the time we entered into the standby purchase agreement:

- were or are insolvent or rendered insolvent by reason of our entry into the standby purchase agreement;
- were or are engaged in business or transactions for which the assets remaining with us constituted unreasonably small capital; or
- intended to incur or incurred, or believed or believes that we would incur, debts beyond our ability to pay such debts as they mature; and
- in each case, intended to receive or received less than reasonably equivalent value or fair consideration therefor,

then our obligations under the standby purchase agreement could be avoided, or claims with respect to the standby purchase agreement could be subordinated to the claims of other creditors. Among other things, a legal challenge to the standby purchase agreement on fraudulent conveyance grounds may focus on the benefits, if any, realized by us as a result of PIFCo s issuance of these notes. To the extent that the standby purchase agreement is held to be a fraudulent conveyance or unenforceable for any other reason, the holders of the PIFCo notes would not have a claim against us under the standby purchase agreement and will solely have a claim against PIFCo. We cannot assure you that, after providing for all prior claims, there will be sufficient assets to satisfy the claims of the PIFCo noteholders relating to any avoided portion of the standby purchase agreement.

ITEM 4. INFORMATION ON THE COMPANY

History and Development of Petrobras

We are a state-controlled company created pursuant to Law No. 2,004 (effective as of October 3, 1953). A state-controlled company is a Brazilian corporation created by special law, of which a majority of the voting capital must be owned by the Brazilian federal government, a state or a municipality. We are controlled by the Brazilian

federal government, but our common and preferred shares are also publicly traded. Our principal executive office is located at Avenida República do Chile, 65, 20031-912 Rio de Janeiro RJ, Brazil and our telephone number is (55-21) 3224-4477.

We were incorporated in 1953 and began operations in Brazil in 1954 as a wholly-owned government enterprise responsible for all hydrocarbon activities in Brazil. Since our foundation, our legal name has been Petróleo Brasileiro S.A. Petrobras. From that time until 1995, we had a government-granted monopoly for all crude oil and natural gas production and refining activities in Brazil. On November 9, 1995, the Brazilian Constitution was amended to authorize the Brazilian government to contract with any state or privately owned company to carry out the activities related to the upstream and downstream segments of the Brazilian oil and gas sector. This amendment made possible the end of our legal monopoly in 1988.

The crude oil and natural gas industry in Brazil has experienced significant reforms since the enactment of Law No. 9,478, or the Oil Law, on August 6, 1997, which established competition in Brazilian markets for crude oil, oil products and natural gas . Effective January 2, 2002, the Brazilian government deregulated prices for crude oil and oil products. See Regulation of the Oil and Gas Industry in Brazil Price Regulation. The gradual transformation of the oil and gas industry since 1997 has led to increased participation by international companies in Brazil across all segments of our business, both as our competitors and partners.

Based upon our 2005 consolidated revenues, we are the largest corporation in Brazil and one of the largest oil and gas companies in Latin America. In 2005, we had sales of products and services of U.S.$74,065 million, net operating revenues of U.S.$56,324 million and net income of U.S.$10,344 million.

We engage in a broad range of oil and gas activities, which cover the following segments of our operations:

Exploration and Production Our exploration and production segment encompasses exploration, development and production activities in Brazil.

Refining, Transportation and Marketing Our refining, transportation and marketing segment encompasses refining, logistics, transportation and the purchase of crude oil, as well as the purchase and sale of oil products and fuel alcohol. Additionally, this segment includes the petrochemical and fertilizers division, which includes domestic petrochemical companies and our two domestic fertilizer plants.

Distribution Our distribution segment encompasses oil product and fuel alcohol distribution activities conducted by our majority owned subsidiary, Petrobras Distribuidora S.A. BR in Brazil.

Natural Gas and Power Our natural gas and power segment encompasses the purchase, sale and transportation of natural gas produced in or imported into Brazil. Additionally, this segment includes our domestic electric energy commercialization activities as well as investments in domestic natural gas transportation companies, state owned natural gas distributors and gas-fired power plants.

International Our international segment encompasses international activities conducted in the following countries: Argentina, Angola, Bolivia, Colombia, Ecuador, Equatorial Guinea, Iran, Libya, Mexico, Nigeria, Paraguay, Peru, the United States, Tanzania,Turkey, Uruguay and Venezuela), which include Exploration and Production, Supply, Refining, Petrochemical, Fertilizers, Distribution and Gas and Energy.,

Corporate Our corporate segment includes those activities not attributable to other segments, including corporate financial management and overhead related with central administration.

As a foreign private issuer, we are exempt from many of the corporate governance standards the New York Stock Exchange, or NYSE, applies to U.S. domestic issuers listed on the NYSE. In accordance with Section 303A.11 of the NYSE Listed Company Manual, we have posted a summary of significant differences between the NYSE standards and our corporate governance practice on our website, www.petrobras.com.br.

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Recent developments relating to compliance with the Sarbanes-Oxley Act

Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, beginning with our Annual Report on Form 20-F for the fiscal year ending December 31, 2006, we will be required to furnish a report by our management on our internal control over financial reporting. This report will contain, among other matters, an assessment of the effectiveness of our internal controls over financial reporting as of the end of the fiscal year, including a statement as to whether or not our internal controls over financial reporting are effective. This assessment must include disclosure of any material weakness in our internal control over financial reporting identified by management.

The report will also contain a statement that our auditors have issued a certification report on management s assessment of such internal controls. Deloitte, Touche Tohmatsu has assisted our management in conducting a preliminary assessment and evaluation of our internal controls.. To comply with this requirement, we are creating a system of internal controls over financial reporting through the Integrated Program for Internal Control Systems and Valuation Methodology, known as PRISMA . PRISMA is a program that focuses on constantly reviewing our financial statements and information contained in our consolidated financial reports. In addition, the program follows orientations from the Public Company Accounting Oversight Board (PCAOB) and from the Committee of Sponsoring Organizations of the Treadway Commission (COSO), for the development of better internal control practices, as well as from Control Objectives for Information and Related Technology (COBIT), as it relates to information technology.

Phases 1 and 2 of the PRISMA have already been implemented and we are currently implementing phase 3 of the program.

Competitive Strengths

We have a number of key strengths, including:

- dominant market position in the production, refining and transportation of crude oil and oil products in Brazil;
- strong reserve base;
- deepwater technological expertise;
- cost efficiencies created by large scale operations combined with vertical integration among business segments;
- strong position in Brazil s growing natural gas markets; and
- success in attracting international partners in all activities.

Dominant market position in the production, refining and transportation of crude oil and oil products in Brazil

Our legacy as Brazil s former sole supplier of crude oil and oil products has provided us with a fully developed operational infrastructure throughout Brazil and a large proved reserve base. Our long history, resources and established presence in Brazil permit us to compete effectively with other market participants and new entrants now that the Brazilian oil and gas industry has been deregulated. We operate all major development fields in Brazil and substantially all of the country s refining capacity. Our average domestic daily production of crude oil and NGLs increased 12.8% in 2005, decreased 3.1% in 2004 and increased 2.7% in 2003.

Strong reserve base

As of December 31, 2005, we had estimated proved developed and undeveloped crude oil and natural gas reserves of approximately 11.77 billion barrels of oil equivalent in Brazil and abroad. In addition, we have a

substantial base of exploration acreage both in Brazil and abroad, which we are exploring by ourselves and with industry partners in order to continue to increase our reserves.

As of December 31, 2005, our worldwide proved reserves to production ratio was 15.4 years.

The majority of our reserves, including recent discoveries, are located in deep-water areas that generally require additional planning, more comprehensive evaluation and added lead time to begin production when compared to onshore production. In accordance with our Business Plan for the period from 2006 to 2010, we have been investing the necessary capital to build the offshore platforms needed to monetize these reserves. Although our proved reserve life is higher than the industry average, the additional planning required to bring deep-water areas into production also means that our percentage of proved undeveloped reserves may be higher than the industry average.

We believe that our proved reserves will provide us with significant opportunities for sustaining and increasing production growth.

Deepwater technological expertise

While developing Brazil s offshore basins over the past 36 years, we have gained expertise in deepwater drilling, development and production techniques and technologies. We are currently in the process of developing technology to permit production from wells at water depths of up to 9,842 feet (3,000 meters).

Our deepwater development and production expertise has allowed us to achieve high production volumes and relatively low lifting costs (excluding royalties, special government participation and rental of areas, which we refer to as government take). Our aggregate average lifting cost for crude oil and natural gas products in Brazil for 2005, excluding government take, increased to U.S.$5.73 per barrel of oil equivalent, as compared to U.S.$4.28 per barrel of oil equivalent for 2004. Including government take, our lifting costs increased to U.S.$14.65 per barrel of oil equivalent for 2005, as compared to U.S.$10.72 per barrel of oil equivalent for 2004.

Cost efficiencies created by large-scale operations combined with vertical integration among business segments

As the dominant integrated crude oil and natural gas company in Brazil, we can be cost efficient as a result of:

- the location of over 80% of our proved reserves in large, contiguous and highly productive fields in the offshore Campos Basin, which allows for the concentration of our operational infrastructure, thereby reducing our total costs of exploration, development and production;

- the location of most of our refining capacity in the Southeast region, directly adjacent to the Campos Basin and situated within the country s most heavily populated and industrialized markets; and

- the relative balance between our current production of 1,684 Mbpd, our refining throughput of 1,726 Mbpd and the Brazilian market total demand for hydrocarbon products of 1,800 Mbpd as of December 2005.

We believe that these cost efficiencies created by our integration, our existing infrastructure and our balance allow us to compete effectively with other Brazilian producers and importers of oil products into the Brazilian market.

Strong position in Brazil s growing natural gas markets

We participate in most aspects of the Brazilian natural gas market. At present, the ability to meet the potential demand for natural gas is limited, due to constraints in gas supply and to a distribution infrastructure that is still under development. The prices we realize for natural gas, which depend on the costs of other energy sources it can replace, are approximately half of the current market price in the United States, where demand is more

developed. The demand for natural gas in Brazil increased 11% in 2005. Although we cannot be certain that natural gas demand will continue to grow at annual rates similar to previous years, we expect continued growth as significant investments in gas transportation pipelines begin operating.

Because of the diversity of our natural gas operations, we believe that we are well positioned to take advantage of the opportunity to meet potentially growing energy needs in Brazil through the use of natural gas. We intend to do so through our:

- increasing production of non-associated natural gas, and natural gas associated with our domestic crude oil production, combined with the necessary investments to process such gas from recent discoveries of non-associated gas reserves, mainly in the Santos Basin offshore in Brazil;
- planned investments in expansion of the natural gas transportation network throughout Brazil;
- increased participation in the natural gas distribution market through investments in 19 of the 25 natural gas distribution companies in Brazil;
- investments in gas-fired power plants, which serve as sources of demand for our natural gas; and
- seeking greater operational flexibility in our sources to improve our energy demand management.

Success in attracting international partners in all our activities

As a result of our experience, expertise and extensive infrastructure network in Brazil, we have attracted partners in our exploration, development, refining and power activities such as Repsol-YPF, ExxonMobil, Shell, British Petroleum, Chevron-Texaco and Total. Partnering with other companies allows us to share risks, capital commitments and technology in our continuing development and expansion.

We may face significant risks in our ability to take full advantage of these competitive strengths. See Item 3. Key Information Risk Factors.

Strategy

We intend to continue to expand our oil and gas exploration and production activities and pursue strategic investments within and outside of Brazil to further develop our business. We seek to evolve from a dominant integrated oil and gas company in Brazil into an energy industry leader in Latin America and a significant international energy company. In line with our Strategic Plan and to further these goals, we intend to:

- consolidate and increase competitive advantages in the Brazilian and South American oil and oil products market;
- selectively expand international activities in an integrated manner with the Company s business;
- develop and lead the domestic natural gas market and act in an integrated manner in the gas and power market in the Southern Cone;
- selectively expand our activities in the domestic and Southern Cone petrochemicals market; and
- selectively perform in the renewable energy market.

Consolidate and increase competitive advantages in the Brazilian and South American oil and oil products market

Our 2006-2010 Business Plan contemplates capital expenditures of approximately U.S.$28 billion in exploration and development activities in Brazil. Through these investments, we plan to implement 17 big scope

projects, among others, aimed at increasing production to 2.3 million bpd by 2010. Our 2006-2010 Business Plan contemplates capital expenditures of approximately U.S.$7.1 billion in exploration and development activities outside of Brazil. These investments will be primarily exploration and development activities in South America. Our other areas of focus will be the Gulf of Mexico and West Africa. At December 2005, we had exploration, development and production rights in 54 million gross and 35 million net acres (220,000 gross and 141,000 net square kilometers) outside Brazil.

At the same time that we seek to expand production, we intend to increase proved reserves, focused on deepwater exploration in Brazil. Our goal is to maintain a ratio of 15.4 years of reserves to production sustainable in the long-term. We have net exploration, development and production rights in 35.3 million acres (142,691 square kilometers) in Brazil. We expect to continue to participate selectively with major regional and international oil and gas companies in bidding for new concessions and in developing large offshore fields.

Our domestic production in 2005 supplied approximately 80% of the crude oil feedstock for our refinery operations in Brazil, as compared to 76% in 2004 and 80% in 2003. We expect an increasing percentage of the crude oil feedstock to be supplied by our relatively lower cost domestic production, as our overall domestic production increases. Because our domestic refining capacity constitutes 98.5% of the Brazilian refining capacity, we supply almost all of the refined product needs of third-party wholesalers, exporters and petrochemical companies, in addition to satisfying our internal consumption requirements with respect to wholesale marketing operations and petrochemical feedstock.

Our refineries were originally designed to process light imported crude oil, whereas our current reserves and production increasingly consist of heavier crude oil. We are in the process of improving and adapting our refineries to better process our domestic production of heavier crude oil.

Selectively expand international activities in an integrated manner with the Company s business.

In the near term, we expect to expand internationally by using our existing asset base or participating in selective partnerships in core activities where we have a competitive advantage. We consider our core activities to be integrated oil and gas operations throughout South America and deepwater exploration and development off the U.S. Gulf Coast, Colombia and West Africa. We also have exploration interests in Angola, Argentina, Bolivia, Colombia, Ecuador, Peru, Nigeria, Equatorial Guinea, Iran, the Gulf of Mexico, Tanzania, Turkey and Libya.

Develop and lead the domestic natural gas market and act in an integrated manner in the gas and power market in the Southern Cone

Through our participation in all segments of the natural gas market, both in Brazil and abroad, we seek to meet domestic natural gas demand. We intend to continue to expand our participation in the natural gas market by:

- developing the natural gas industry on an integrated manner with other areas of our Company in the production chain and consumption; and
- taking advantage of growing opportunities in the power industry in an integrated manner with other natural gas market areas in which our Company already operates.

As a result of our investments and the growing importance of natural gas as a cleaner energy alternative, we anticipate that the proportion of revenues and assets represented by natural gas operations will increase, leading to a greater impact of these activities on our results of operations.

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Selectively expand our activities in the domestic and Southern Cone petrochemicals market

We intend to expand activities in the petrochemical and fertilizer markets by seeking strategic partnerships and creating synergies with existing business. Our 2006-2010 Business Plan contemplates investments of approximately U.S.$2.0 billion in petrochemical business. Such investment will be aimed at increasing production of our basic petrochemicals, including polyolefins (polyethylene and polypropylene), acrylic acid and terephtalic acid. We believe that the growth of petrochemical activities will generate synergies with refining activities and we intend to take benefit of the expected growth in the petrochemical market in Brazil. We also intend to build a basic petrochemical complex that will integrate refinery units and petrochemical facilities to produce petrochemical raw materials such as ethylene, propylene, aromatics and its petrochemical derivatives, such as polyethylene and polypropylene. The total estimated aggregate investment for the construction of this petrochemical complex is approximately U.S.$6.5 billion and it is expected that it will begin operating in 2012.

Selectively perform in the renewable energy market

We intend to develop some renewable energy alternatives in Brazil. Our priorities for investments in renewable sources of energy are:

- bio-diesel production and H-bio;
- wind power generation;
- biomass energy; and
- photo voltaic.

Overview by Business Segment

Exploration, Development and Production

Summary and Strategy

Our exploration and production segment includes exploration, development and production activities in Brazil. We began domestic production in 1954 and international production in 1972. As of December 31, 2005, our estimated net proved crude oil and natural gas reserves in Brazil were approximately 10.58 billion barrels of oil equivalent. Crude oil represented 85% and natural gas represented 15% of these reserves. Our proved reserves are located principally in the Campos Basin.

During 2005, our average daily domestic production was 1,684 Mbpd of crude oil and NGLs and 1.643 billion cubic feet of natural gas per day. Our aggregate average lifting costs for crude oil and natural gas in 2005 were U.S.$5.73 per barrel of oil equivalent in Brazil (excluding government take).

We conduct exploration, development and production activities in Brazil through concession contracts. Under the terms of the Oil Law, in 1998 we were granted the concession rights to areas where we were already producing or could demonstrate we could explore or develop within a certain time frame. We refer to these concessions as Round zero. In a number of concessions, we have joint ventures with foreign partners to explore and develop the concessions. In conjunction with the majority of these arrangements, we received a carried interest for capital expenditures made during the exploration phase, with our partners incurring all capital expenditures until the development of a commercial discovery commences.

At December 31, 2005, we held 418 areas, representing 35.3 million net acres (142,691 square kilometers). We currently have joint venture agreements for exploration and production in Brazil with 26 foreign and domestic companies. We are also active in exploration and production activities outside Brazil. For a full description of our international activities, see " International Exploration and Production. In addition, we have added to our

exploration acreage through our participation in bidding rounds that have been conducted annually by the ANP since 1999.

Our main strategies in exploration, development and production in Brazil are to increase production and reserves by:

- strengthening our expertise in deep and ultra-deep waters;
- focusing on profitable opportunities on-shore and in shallow water fields;
- implementing new practices and new technologies in areas with high exploitation degree in order to optimize recovery factor;
- developing exploratory efforts in new frontiers in order to assure a sustainable reserve/production ratio.

Principal Domestic Oil and Gas Producing Regions

Our annual daily production in Brazil has generally grown over the years. In 1970, we produced 164 Mbpd of crude oil, condensate and natural gas liquids in Brazil. We increased production to 181 Mbpd in 1980, 654 Mbpd in 1990, 1,271 Mbpd in 2000 and 1,684 Mbpd in 2005. In describing our oil and gas producing regions, reservoirs refer to underground formations containing producible oil or gas. Fields are areas that contain one or more reservoirs. Blocks are sections of a sedimentary basin where we carry out oil and gas exploration and production activities under concession contracts.

Our main domestic oil and gas producing regions are:

Campos Basin

The Campos Basin is the largest oil and gas producing region, and covers approximately 28.4 million acres (115 thousand square kilometers). Since exploration activities in this area began in 1968, over 45 hydrocarbon reservoirs have been discovered in this region in a 7.5 thousand square kilometers concession area, including eight large oil fields in deepwater and ultra deepwater. In terms of proved hydrocarbon reserves and annual production, the Campos Basin is the largest oil basin in Brazil and one of the most prolific oil and gas areas in South America. Annual crude oil production volume in the region increased steadily for the past ten years until 2004, when oil production in the Campos Basin decreased to 1,204 Mbpd from 1,252 Mbpd in 2003. In 2005, oil production in the Campos Basin increased to 1,405 Mbpd. The Campos Basin s oil production accounted for approximately 83% of Brazilian oil production in 2005.

At December 31, 2005, we produced crude oil from 36 fields in the Campos Basin and its proved crude oil reserves were 7.89 billion barrels, representing 81% of our total proved crude oil reserves. In 2005, the crude oil we produced in the Campos Basin had an average API gravity of 23.5 and an average water cut of 1%. We currently have 26 floating production systems, 13 fixed platforms and 5,226 kilometers of pipeline and flexible pipes operating in 45 fields at water depths of 262 to 6,188 feet (80 to 1,886 meters) in the Campos Basin.

Espírito Santo Basin

We have made several discoveries of light oil and natural gas in the Espírito Santo Basin. We currently have exploration rights to 23 blocks in this Basin, 12 onshore and 11 offshore, with an exploration acreage of 10.4 thousand square kilometers. During 2005, we produced 42.7 Mboe per day of oil and natural gas in the Espírito Santo Basin (25.7 Mboe onshore and 17.1 Mboe offshore). On February 21, 2006, we began gas production in the Basin s Peroá Field.

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Santos Basin

The Santos Basin represents one of the most promising exploration areas. In January of 2006, we approved the Master Plan for Development of Natural Gas and Oil Production in the Santos Basin, with a base of exploration and production in the city of Santos, in the state of São Paulo. We currently have exploration rights to 26 blocks in the Santos Basin, with an exploration acreage of 40.7 thousand square kilometers (as compared to 13.7 thousand square kilometers under concession in the Campos Basin). Current production of oil and natural gas is 10.87 Mboe per day in the Coral and Merluza fields. We have drilled the first exploratory well in the ultra-deep waters of the Basin and have found evidence of oil.

Properties

The following table sets forth our developed and undeveloped gross and net acreage by oil region and associated crude oil and natural gas production:

	Production Acreage as pf December 31.,2005				Average Oil and Natural Gas Production for the Year Ended December 31, 2005(1)(4)	Average Oil and Natural Gas Production for the Year Ended December 31, 2004(1)(4)
	Developed		Undeveloped			
	Gross(2)	Net(2)	Gross(2)	Net(2)		
	(in acres)				(boe per day) (3)	
Brazil(1)						
Offshore						
Campos Basin	1,714,851	1,681,740	138,374	99,580	1,530,147	1,311,208
Other offshore	320,979	281,196	329,874	291,327	64,510	68,909
Total offshore	2,035,830	1,962,936	468,248	390,907	1,594,657	1,380,117
Onshore	1,045,466	1,045,466	131,949	131,950	363,203	377,603
Total Brazil	3,081,296	3,008,402	600,197	522,857	1,957,860	1,757,720
International						
Onshore	4,225,975	2,584,034	2,967,718	1,871,834	245,828	247,122
Offshore	123,825	36,381	642,109	81,778	12,909	15,516
Total International	4,349,800	2,620,415	3,609,827	1,953,612	258,737	262,638
Total	7,431,096	5,628,817	4,210,024	2,476,469	2,216,597	2,020,358

(1) Over 75% of our production of natural gas is associated gas.

(2) A gross acre is an acre in which a working interest is

owned. The number of gross acres is the total number of acres in which a working interest is owned. A net acre is deemed to exist when the sum of fractional ownership working interests in gross acres equals one. The number of net acres is the sum of the fractional working interests owned in gross acres expressed as whole numbers and fractions thereof.

(3) See Conversion Table for the ratios used to convert cubic feet of natural gas to barrels of oil equivalent.

(4) Includes production from shale oil reserves, natural gas liquids and reinjected gas volumes, which are not included in our proved reserves figures.

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The following table sets forth our total gross and net productive wells as of December 31, 2005:

	Productive Wells		
	Oil	**Gas**	**Total**
Gross productive wells			
Brazil	8,968	468	9,436
International	5,896	302	6,198
Total	14,864	770	15,634
Net productive wells			
Brazil	8,954	465	9,419
International	4,361	235	4,596
Total	13,315	700	14,015

Productive wells are those producing or capable of production. A gross well is one in which a working interest is owned. The number of gross wells is the total number of wells in which a working interest is owned. A net well is deemed to exist when the sum of fractional ownership working interests in gross wells equals one. The number of net wells is the sum of the fractional working interests owned in gross wells expressed as whole numbers and fractions thereof.

Deepwater Expertise

We are the leader in deepwater drilling, with recognized expertise in deepwater exploration, development and production. We have developed expertise over many years and have achieved significant milestones, including the following:

- in January 2003, we drilled the world s second horizontal deepwater multilateral well in the Barracuda-Caratinga field, in Campos Basin, at an water depth of 2,999 feet (914 meters), consisting of two legs for each well;
- at December 31, 2005, we were operating 37 wells at water depths in excess of 3,281 feet (1,000 meters)
- at December 31, 2005, we had drilled 400 wells at water depths in excess of 3,281 feet (1,000 meters), the deepest well being an exploration well in water depth of 9,360 feet (2,853 meters).

Because many of Brazil s richest oil fields are located offshore in deep waters, we intend to continue to focus on deepwater production technology to increase our proved reserves and future domestic production. See Item 5. Operating and Financial Review and Prospects Research and Development. Our main exploration and development efforts involve offshore fields neighboring existing fields and production infrastructure, where higher drilling costs have been offset by higher drilling success ratios and relatively higher production. On a per-well basis, the exploration, development and production costs offshore are generally higher than those onshore. We believe, however, that offshore production is cost-effective, because historically:

- we have been more successful in finding and developing crude oil offshore, as a result of the existence of a larger number and size of oil reservoirs offshore as compared to onshore reservoirs and a greater volume of offshore seismic data collected; and
- we have been able to spread the total costs of exploration, development and production over a large base, given the size and productivity of our offshore reserves. Offshore production has exceeded onshore production by a per barrel production ratio of 5.92:1 in 2005, 4.96:1 in 2004 and 5.20:1 in 2003.

We currently extract hydrocarbons from offshore wells in waters with depths of up to 6,188 feet (1,886 meters), and we have been developing technology to permit production from wells at water depths of up to 9,843 feet (3,000 meters). Set forth below is the distribution, by water depth, of offshore oil production in 2005 and 2004.

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OFFSHORE PRODUCTION BY WATER DEPTH

Depth	Percentage in 2005	Percentage in 2004
0-400 meters (0-1,312 feet)	18%	21%
400-1,000 meters (1,312 feet-3,281 feet)	56%	55%
More than 1,000 meters (3,281 feet)	26%	24%

Exploration Activities

Concessions in Brazil

We had the right to exploit all exploration, development and production areas in Brazil as a result of the monopoly granted to us by Brazilian Law. When regulatory changes in the Brazilian oil and gas sector began in 1998, monopoly ended. On August 6, 1998, we signed concession contracts with the ANP for all of the areas we had been using prior to 1998. Those concession contracts covered 397 areas, consisting of 231 production areas, 115 exploration areas and 51 development areas, for a total area aggregating 113.3 million gross acres (458.5 thousand square kilometers).

At December 31, 2005, we had 418 areas, consisting of 243 production areas, 134 exploration areas and 41 development areas, for a total area aggregating 43.3 million gross acres (175.4 thousand square kilometers). This total area represents 2.7% of the Brazilian sedimentary basins.

Recent discoveries

In 2005, we declared the commercial feasibility of many new oil and gas fields, the main ones being located in the Espírito Santo, Campos and Santos Basins. We also made minor discoveries in the onshore coastal basins of Sergipe-Alagoas, Potiguar, Recôncavo and Espírito Santo. In 2005, we presented ANP Declarations of Commerciality for eight (8) new oil and gas fields.

The Papa-Terra field is located in the southern Campos basin and operated by us (with a 62,5% interest) in partnership with Chevron-Texaco, with recoverable volumes that we believe may reach 700 million to 1 billion boe. In addition, we discovered new oil accumulation inside the ring-fence limits of the Marlim Leste field, in deeper reservoirs than the usual ones for the Campos Basin.

In the offshore Santos Basin we discovered light crude oil and gas in the Tambaú and Uruguá fields, with recoverable volumes of more than 270 million boe.

In the Espírito Santo Basin we discovered both light crude oil and gas in the Canapu field.

In the onshore coastal basins we discovered and declared commercial the fields of Acauã, in the Potiguar basin, Anambé, in the Sergipe-Alagoas basin, Jandaia, in the Recôncavo basin and Inhambú in the Espírito Santo basin.

We have a 35% interest in the Abalone, Ostra, Nautilus and Argonauta fields declared commercial by Shell, operator of the concession, in the northern part of the Campos basin, adjacent to the Jubarte/Cachalote area.

We had a 55% success ratio for our exploration wells during 2005, with 38 wells classified as discovery or producing wells.

Auctions of exploration rights

Since 1999, ANP has conducted auctions of exploration rights, which are open to us and qualified companies. We have competed in the public auctions, acquiring a large number of exploration rights, as detailed in

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the table below. We have also relinquished a considerable number of the exploratory areas in which we were not interested or successful in exploring.

The following chart summarizes our success in the exploration bidding rounds conducted by the ANP during the last three years:

Event	Exploration	Development	Production	Total
Areas held (December 31, 2002)	58	39	234	331
Areas redefined (July 2003) (BCAM-40)	1	0	0	1
Areas relinquished (August 6, 2003)	(22)	0	0	(22)
Areas won on Bid, Round 5	17	0	0	17
New concession (January 29, 2003) (Guajá)	0	1	0	1
New concession (August 4, 2003) (Cavalo-Marinho)	0	1	0	1
Areas redefined (February 3, 2003) (Coral)	0	(1)	1	0
Areas redefined (July 15, 2003) (Beija-Flor)	0	(1)	1	0
Joint concession COG to CCN (1)	0	0	(1)	(1)
Joint concession CDL to MP (2)	0	0	(1)	(1)
Areas relinquished (BAS-104)	0	(1)	0	(1)
Areas relinquished (Arraia)	0	(1)	0	(1)
Joint concession CR to FBL (3)	0	(1)	0	(1)
Areas relinquished (ALS-32)	0	(1)	0	(1)
Areas held (December 31, 2003)	54	35	234	323
Areas won on Bid, Round 6	36	0	0	36
Areas obtained through acquisitions (BT-REC-4, BT-POT-9, BT-ES-4, BM-C-14, BM-S-14 and BM-S-22)	6	0	0	6
Joint concession SMI to PJ (4)	0	0	(1)	(1)
New concession (January 15, 2004) (Baleia Franca)	0	1	0	1
New concession (January 15, 2004) (Golfinho)	0	1	0	1
New concession (January 15, 2004) (Mexilhão)	0	1	0	1
New concession (January 19, 2004) (Azulão)	0	1	0	1
New concession (January 19, 2004) (Japim)	0	1	0	1
New concession (August 30, 2004) (Piranema)	0	1	0	1
New concession (December 20, 2004) (Baleia Anã)	0	1	0	1
New concession (December 20, 2004) (Baleia Azul)	0	1	0	1
New concession (December 20, 2004) (Baleia Bicuda)	0	1	0	1
New concession (December 22, 2004) (Salema Branca)	0	1	0	1
Areas held (December 31, 2004)	96	45	233	374

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	Exploration	Development	Production	Total
Areas won on Bid, Round 7	39	0	0	39
Areas relinquished (until December 31, 2005) (BM-FZA-1)	(1)	0	0	(1)
New concession (February 1, 2005) (Jandaia)	0	1	0	1
New concession (April 4, 2005) (Anambé)	0	1	0	1
New concession (July 14, 2005) (Acauã)	0	1	0	1
New concession (November 24, 2005) (Inhambu)	0	1	0	1
New concession (December 27, 2005) (Papa-Terra)	0	1	0	1
New concession (December 29, 2005) (Uruguá)	0	1	0	1
New concession (December 29, 2005) (Tambaú)	0	1	0	1
New concession (December 29, 2005) (Canapú)	0	1	0	1
Areas redefined (January 17, 2005) (Rio Joanes)	0	(1)	1	0
Areas redefined (February 1, 2005) (Fazenda Sori)	0	(1)	1	0
Areas redefined (February 25, 2005) (Camaçari)	0	(1)	1	0
Areas redefined (March 3, 2005) (Jandaia)	0	(1)	1	0
Areas redefined (April 1, 2005) (Fazenda Matinha)	0	(1)	1	0
Areas redefined (April 12, 2005) (Quererá)	0	(1)	1	0
Areas redefined (June 18, 2005) (Rio da Serra)	0	(1)	1	0
Areas redefined (August 11, 2005) (Anambé)	0	(1)	1	0
Areas redefined (August 13, 2005) (Fazenda Santa Rosa)	0	(1)	1	0
Areas redefined (November 24, 2005) (Inhambu)	0	(1)	1	0
Joint concession BBI to CHT(5)	0	(1)	0	(1)
Joint concession NPE to DEN (6)	0	(1)	0	(1)
Total areas held (as of December 31, 2005)	**134**	**41**	**243**	**418**
Net area held in million acres (as of December 31, 2005)	**31,727,205**	**522,856**	**3,008,401**	**35,258,462**

(1) COG Córrego Grande, CCN Córrego Cedro Grande

(2) CDL Cardeal, MP Massapê

(3)

CR Curió, FBL
Fazenda Belém

(4) SMI São
Miguel, PJ
Pajeú

(5) BBI Baleia
Bicuda, CHT
Cachalote

(6) NPE Norte de
Pescada, DEN
Dentão

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Joint Ventures

As of December 31, 2005, we had 68 exploration agreements and 16 production agreements. Our participation ranges from 30% to 85% in the exploration agreements, and in 47 of the 68 agreements we are principally responsible for conducting the exploration activities. During 2005, we entered into 23 partnership projects relating to exploration activities. As of December 31, 2005, we had partnerships in exploration with 20 foreign and domestic companies.

Drilling Activities

During 2005, we drilled a total of 361 wells, 292 development wells and 69 exploratory wells. Of those wells, 251 development wells and 36 exploratory wells were located onshore and 41 development wells and 33 exploratory wells were located offshore. These numbers refer to the wells we drilled in 2005, but such wells may not have been evaluated or reclassified in 2005. The table Exploratory and Development Wells below indicates the number of wells which were evaluated and reclassified in 2005.

We plan to expand exploration and development activities in 2006 by:

- drilling approximately 92 new exploratory and approximately 356 new development wells;
- shooting and processing two-dimensional and three-dimensional seismic surveys; and
- constructing onshore and offshore production and support facilities.

The following table sets forth the number of wells we drilled, or in which we participated, and the results achieved, for the periods indicated.

EXPLORATORY AND DEVELOPMENT WELLS

Period	Campos Basin	Other	Onshore	International	Total
2005 Net Exploratory Wells Drilled	19	14	36	4	73
Successful	14	7	17	4	42
Unsuccessful	5	7	19	0	31
Net Development Wells Drilled	20	3	187	207	417
Successful	19	3	181	206	409
Unsuccessful	1	0	6	1	8
2004 Net Exploratory Wells Drilled	21	19	14	7	61
Successful	16	9	4	2	31
Unsuccessful	5	10	10	5	30
Net Development Wells Drilled	25	2	208	235	470
Successful	24	2	205	230	461
Unsuccessful	1	0	3	5	9
2003 Net Exploratory Wells Drilled	21	10	7	4	42
Successful	7	2	2	2	13
Unsuccessful	14	8	5	2	29
Net Development Wells Drilled	12	0	264	26	302
Successful	12	0	256	26	294
Unsuccessful	0	0	8	0	8

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The following table sets forth our fleet of drilling rig units. We will use these owned and leased rigs to support future exploration, production and development activities. Most of the offshore rigs are operated in the Campos Basin.

DRILLING UNITS

	2005		2004		2003	
	Brazil	**International**	**Brazil**	**International**	**Brazil**	**International**
Land rigs for onshore exploration and development	22	19	19	28	15	10
Owned	13	0	13	0	13	0
Leased	9	19	6	28	2	10
Semi-submersible rigs	17	1	18	0	17	0
Owned	3	0	4	0	4	0
Leased	14	1	14	0	13	0
Drill ships	7	2	7	1	8	1
Owned	0	0	0	0	0	0
Leased	7	2	7	1	8	1
Jack-up rigs	7	1	6	0	6	0
Owned	6	0	6	0	5	0
Leased	1	1	0	0	1	0
Moduled rigs for offshore exploration and development	11	0	11	0	9	0
Owned	9	0	8	0	6	0
Leased	2	0	3	0	3	0
Total	64	23	61	29	55	11

Development Activities

Development occurs after completion of exploration and appraisal, and prior to hydrocarbon production, and involves the installation of production facilities including platforms and pipelines. We have an active development program in existing fields and in the discovery and recovery of new reserve finds. Over the last five years, we have concentrated development investments in the deepwater fields located in the Campos Basin, where most of our proved reserves are located. We develop fields in stages of production, which we refer to as modules. As of December 31, 2005, we had a total of 7,961 oil and gas producing wells in Brazil, of which 7,283 were onshore and 678were offshore.

Campos Basin Fields

Marlim. The Marlim field is located at water depths between 2,133 and 3,445 feet (650 1,050 meters). It is our largest field based on production. Average production of crude oil during 2005 was 466.2 Mbpd, or more than 33% of total production in the Campos Basin. We have developed the Marlim field in five modules. We currently have seven floating production systems with total capacity of 710 Mbpd operating in Marlim field. We have a total of 73 production wells and 46 injection wells, and expect to drill four wells in 2006. Peak production of 586.3 Mboe was achieved in 2002.

Roncador. The Roncador field is located in water depths between 4,921 and 6,234 feet (1,500 1,900 meters). Average production of crude oil during 2005 was 83.0 Mbpd. The first module of the development of this field consisted of Platform P-36, which sank in March 2001, and which was producing 80 Mbpd prior to the accident. Since the loss of P-36, we have contracted a temporary Floating Production Storage and Offloading unit (FPSO Brazil) with capacity of 90 Mbpd. First oil from this unit was attained on December 8, 2002. A total of seven wells, which were previously attached to P-36, have been attached to the new FPSO unit. A second platform (P-52) with a 180 Mbpd capacity is under construction. First oil from the unit is expected in 2007. A total of 20 production wells are planned in this module, including nine which were completed before the sinking of P-36.

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The contracts for a third production unit, with production capacity of 180 Mbpd, were signed on June 17, 2004. The production unit consists of an FPSO (P-54), which is expected to begin production in 2007. A total of eleven production wells and six injection wells are planned.

Marlim Sul (South Marlim). The Marlim Sul field is located at water depths between 2,789 and 7,874 feet (850 2,400 meters). Production of crude oil began on December 17, 2001. In 2005, average production for Marlim Sul was 197 Mbpd. We plan to develop the Marlim Sul field in two modules. The first module includes a production system consisting of a semi-submersible platform (P-40), with a total capacity of 155 Mbpd an FSO (P-38) and one FPSO unit (Marlim Sul) with a total capacity of 100 Mbpd 13 wells are currently producing through P-40, out of a total of 16 planned production wells and ten injection wells. Production from the Marlim Sul FPSO unit began on June 7, 2004 and is currently producing 71.0Mboe per day.

The contracts for a second module, with a production capacity of 180 Mbpd, were signed on June 17, 2004. On December 5, 2005, Petrobras contracted funding for U.S.$402 million towards the construction. The production system consists of a semi-submersible unit (P-51), which is expected to begin production in 2008. A total of 14 production wells and ten injection wells are planned.

Barracuda and Caratinga. The Barracuda and Caratinga fields are located at water depths between 2,274 and 3,899 feet (700 1,200 meters). Oil production began in December 2004 through FPSO unit P-43. Another FPSO unit, P-48, started production in the Caratinga field in February 2005. Each FPSO unit has capacity of 150 Mbpd. A total of 32 production wells and 22 injection wells are planned for the two fields. In 2005, the average production for Barracuda was 124,333 bpd and for Caratinga was 80,302 bpd.

Albacora Leste (East Albacora). Albacora Leste is located at water depths between 3,609 and 4,921 feet (1,100 1,500 meters). FPSO unit (P-50) with capacity of 180 Mbpd started production on April 21, 2006. A total of 16 production wells and 14 injection wells are planned.

Other developments in the Campos Basin include: (1) the Jubarte field, which will bring into production an FPSO (P-34) with 60 Mbpd capacity, (2) the Frade field, and (3) the Marlim Leste field, that will have an FPU unit (P-53) with a 180 Mbpd capacity. A contract to increase the production capacity of P-34 to 60 Mbpd was signed on June 17, 2004. During 2005, we made additional discoveries of crude oil in the Jubarte and Marlim Leste fields and we declared the commercial feasibility of the Papa-Terra field.

Espírito Santo Basin Fields

In February of 2006, we started gas production in the Peroá Field, reaching more than 1 million cubic meters per day. The Peroá platform is projected to process 8 million cubic meters per day and investments include one fixed platform, one submarine gas pipeline and one Gas Treatment Unit (UTGC).

The Golfinho field, already producing through a pilot system, that consists of an FPSO unit (Seillean) with a capacity of 25 Mbpd will be developed through three modules. Module I of the Golfinho Field started production on May 8 with a chartered FPSO named Capixaba, which has a capacity to produce 100 thousand barrels per day and has a storage capacity of 1.6 million barrels.The FPSO (Cidade de Vitória) to be allocated to Module II will have a production capacity of 100 thousand barrels per day and will be able to store up to 1.6 million barrels. Finally, an FPSO to Module III will be chartered, with a production capacity of 100 thousand barrels per day.

Some of these fields are being financed through project financings. See Item 5. Operating and Financial Review and Prospects Liquidity and Capital Resources Project Finance.

Santos Basin Fields

In January of 2006, we approved a Master Plan for Development of Natural Gas and Oil Production in the Santos Basin comprising Five Poles: Merluza, Mexilhão, BS-500, Southern and Central.

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This Master Plan includes the expansion of the Merluza-1 Platform s output to 2.5 million cubic meters of gas per day, the installation of the Merluza-2 Platform, with a production capacity of 8 million cubic meters of gas per day, and the installation of the Mexilhão Platform with a production capacity of 15 million cubic meters of gas per day.

We also plan to install a gas treatment plant on the coast of São Paulo State to be integrated with the projects in order to expand the Merluza Pole and develop the Mexilhão Pole.

In the BS-500 block we began studies for the production of the Uruguá and Tambaú Fields.

In the Southern area, the Coral platform is already operational, currently producing 9,000 barrels of oil per day. There are plans to start production in the Cavalo Marinho Field in the future with production estimated at similar levels to that of Coral.

Finally, the Central area is in the exploratory stage. We see a major potential in this area of the Santos Basin, informally known as a cluster.

Production Activities

Our domestic crude oil and natural gas production activities involve fields located on Brazil s continental shelf off the coast of nine Brazilian states, of which the Campos Basin is the most important region, and onshore in eight Brazilian states. We are also producing crude oil and natural gas in nine other countries: Angola, Argentina, Bolivia, Colombia, Ecuador, Mexico, Peru, the United States, and Venezuela. See International.

The following table sets forth average daily crude oil and natural gas production, average sales price and average lifting costs for each of 2005, 2004 and 2003:

	For the Year Ended December 31,		
	2005	**2004**	**2003(1)**
Crude Oil and NGL Production (in Mbpd)			
Brazil (2)			
Offshore			
Campos Basin	1,405	1,204	1,252
Other	36	38	39
Total offshore	1,441	1,242	1,291
Onshore	243	251	248
Total Brazil	1,684	1,493	1,540
International	163	168	161
Total crude oil and NGL production	1,847	1,661	1,701
Crude Oil and NGL Average Sales Price (U.S. dollars per Bbl)			
Brazil	$ 45.42	$ 33.49	$ 27.01
International	34.91	26.51	23.77
Natural Gas Production (in Mmcfpd)			
Brazil(3)			
Offshore			
Campos Basin	752	645	657
Other	172	184	186
Total offshore	924	829	843
Onshore	719	762	657
Total Brazil	1,643	1,590	1,500

International	575	564	510
Total natural gas production	2,218	2,154	2,010
Natural Gas Average Sales Price (U.S. dollars per Mcf)			
Brazil(4)	$ 2.17	$ 1.93	$ 1.79
International(5)	1.64	1.17	1.26
Aggregate Average Lifting Costs (oil and natural gas) (U.S. dollars per boe)			
Brazil			
With government take	$ 14.65	$ 10.72	$ 8.62
Without government take	5.73	4.28	3.48
International	2.90	2.60	2.46

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(1) International production figures for 2003 include PEPSA and PELSA as of January 1, 2003, although our interests were only acquired in May 2003.

(2) Brazilian figures include production from shale oil reserves and natural gas liquids, which are not included in our proved reserves figures.

(3) Brazilian figures include reinjected gas volumes, which are not included in our proved reserves figures.

(4) Excludes (1) exploration and production overhead; (2) costs related to intra-company transfers of oil products to our exploration and production division; (3) costs of sales of oil products produced in natural plants overseen by our

exploration and production department; and (4) price of oil and gas bought from partners in certain joint ventures.

(5) Excludes (1) royalties; (2) special government participation; and (3) rental of areas.

Average Brazilian production of crude oil and NGL for 2005 increased 12.8% relative to 2004, reaching 1,684 Mbpd, principally as a result of the start-up of FPSO-MLS in June 2004, the P-43 platform in December 2004 and the P-48 platform in February 2005.

Reserves

Our estimated worldwide proved reserves of crude oil and natural gas as of December 31, 2005 totaled 11.77 billion barrels of oil equivalent, including:

- 9.72 billion barrels of crude oil and NGLs; and
- 12,351.9 billion cubic feet of natural gas.

We calculate reserves based on forecasts of field production, which depend on a number of technical parameters, such as seismic interpretation, geological maps, well tests and economic data. All reserve estimates involve some degree of uncertainty. The uncertainty depends mainly on the amount of reliable geologic and engineering data available at the time of the estimate and the interpretation of this data. Therefore, the reliability of reserve estimates depends on factors that are beyond our control and many of such factors may prove to be incorrect over time.

DeGolyer and MacNaughton, or D&M, reviewed and certified 90.6% of our domestic proved crude oil, condensate and natural gas reserve estimates as of December 31, 2005. The estimates for the certification were performed in accordance with Rule 4-10 of Regulation S-X of the SEC.

As of December 31, 2005, our domestic proved developed crude oil reserves represented 45% of our total domestic proved developed and undeveloped crude oil reserves. Our domestic proved developed natural gas reserves represented 44% of our total domestic proved developed and undeveloped natural gas reserves. Total domestic proved hydrocarbon reserves on a barrel of oil equivalent basis increased at an average annual growth rate of 4.7 % in the last five years. Natural gas proved reserves increased at an average annual growth rate of 7.7% over the same period.

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The following table sets forth our estimated net proved developed and undeveloped reserves and net proved developed reserves of crude oil and natural gas by region as of December 31, 2005, 2004 and 2003:

WORLDWIDE ESTIMATED NET PROVED RESERVES

	Brazil			International			Combined Global Proved
	Crude Oil (MMbbl)	Natural Gas(1)(3) (Bcf)	Combined(2)(3) (Mmboe)	Crude Oil (MMbbl)	Natural Gas(1) (Bcf)	Combined(2) (Mmboe)	Reserves (Mmboe)
Net Proved Developed and Undeveloped Reserves:							
Reserves as of December 31, 2003	9,051.4	8,111.4	10,403.3	720.7	3,090.9	1,235.9	11,639.2
Revisions of previous estimates	(414.9)	(262.1)	(458.6)	(18.8)	276.4	27.3	(431.3)
Extensions, discoveries and improved recovery	1,129.3	582.6	1,226.4	60.6	116.5	80.0	1,306.4
Sales of reserves in place	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Purchase of reserves in place	0.0	0.0	0.0	0.6	18.5	3.7	3.7
Production for the year	(522.4)	(477.6)	(602.0)	(61.1)	(209.5)	(96.0)	(698.0)
Reserves as of December 31, 2004	9,243.4	7,954.3	10,569.1	702.0	3,292.8	1,250.9	11,820.0
Revisions of previous estimates	123.0	842.4	263.4	0.5	(32.6)	(4.97)	258.4
Extensions, discoveries and improved recovery	252.0	996.9	418.2	38.4	38.8	44.9	463.1
Purchase of reserves in place	0	0	0	0.0	0.0	0.0	0
Sales of reserves in place	0	0	0	0.0	0.0	0.0	0
Production for the year	(584.5)	(529.8)	(672.8)	(58.8)	(210.9)	(93.9)	(766.7)
Reserves as of December 31, 2005	9,033.9	9,263.8	10,577.9	682.1	3,088.1	1,196.8	11,774.7
Net Proved Developed Reserves:							
As of December 31, 2003	3,629.5	4,398.1	4,362.5	404.1	2,548.4	828.8	5,191.3

As of December 31, 2004	4,129.8	4,427.6	4,867.7	383.1	2,495.2	799.0	5,666.7
As of December 31, 2005	4,071.7	4,088.8	4,753.2	365.9	2,333.7	754.9	5,508.1

(1) Natural gas liquids are extracted and recovered at natural gas processing plants downstream from the field. The volumes presented for natural gas reserves are prior to the extraction of natural gas liquids.

(2) See Conversion Table for the ratios used to convert cubic feet of natural gas to barrels of crude oil equivalent. Production of shale oil and associated reserves are not included.

(3) Natural gas reserve data for 2005 presented in this table in cubic feet have been restated using a conversion of 6000 cubic feet of natural gas per barrel of oil equivalent, such conversion rate being consistent

with prior years volumetric statements. The FAS 69 information originally published together with the consolidated financial statements for December 31, 2005 converted the natural gas reserves using 5613 cubic feet per barrel of oil, such factor being related to specific gravity and calorific content of Petrobras fields rather than the international average standard. As Petrobras natural gas reserves and production are accounted for in cubic meters, this change which is only for convenience presentation of barrel of oil equivalent, has no effect on the financial results nor on the physical natural gas reserves.

The following tables set forth our crude oil and natural gas proved reserves by region, as of December 31, 2005, 2004 and 2003:

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CRUDE OIL NET PROVED RESERVES BY REGION

	As of December 31,					
	2005		2004		2003	
	Proved Developed and Undeveloped	Proved Developed	Proved Developed and Undeveloped	Proved Developed	Proved Developed and Undeveloped	Proved Undeveloped
	(MMbbl)					
Brazil						
Offshore						
Campos Basin	7,886.0	3,395.9	8,130.4	3,422.7	8,089.1	2,899.6
Other	388.3	101.3	335.4	106.1	159.8	111.7
Total offshore	8,274.3	3,497.2	8,465.8	3,528.8	8,248.9	3,011.3
Onshore	759.6	574.5	777.6	601.0	802.5	618.2
Total Brazil	9,033.9	4,071.7	9,243.4	4,129.8	9,051.4	3,629.5
International						
Other South America(1)	625.8	350.8	678.4	367.0	703.9	387.6
West Coast of Africa	42.6	8.6	11.8	11.8	14.0	14.0
Gulf of Mexico	13.7	6.5	11.8	4.3	2.8	2.4
Total international	682.1	365.9	702.0	383.1	720.7	404.1
Total	9,716.0	4,437.6	9,945.4	4,512.9	9,772.1	4,033.6

(1) Includes Argentina, Bolivia Colombia, Ecuador, Peru and Venezuela.

NATURAL GAS NET PROVED RESERVES BY REGION:

	As of December 31,					
	2005		2004		2003	
	Proved Developed and Undeveloped	Proved Developed	Proved Developed and Undeveloped	Proved Developed	Proved Developed and Undeveloped	Proved Undeveloped
	(Bcf)					
Brazil						
Offshore						
Campos Basin	3,836.5	1,772.3	4,039.3	1,820.4	4,096.2	1,598.0
Other	2,912.1	720.9	1,337.5	854.0	1,291.2	959.5

Total offshore	6,748.6	2,493.2	5,376.8	2,674.4	5,387.4	2,557.5
Onshore	2,515.2	1,595.6	2,577.5	1,753.2	2,724.0	1,840.6
Total Brazil	9,263.8	4,088.8	7,954.3	4,427.6	8,111.4	4,398.1
International						
Other South America(1)	2,951.7	2,270.2	3,162.2	2,456.2	3,058.2	2,526.8
Gulf of Mexico	136.5	63.5	130.6	39.0	32.7	21.6
Total international	3,088.1	2,333.7	3,292.8	2,495.2	3,090.9	2,548.4
Total	12,351.9	6,422.5	11,247.1	6,922.8	11,202.3	6,946.5

(1) Includes Argentina, Bolivia, Colombia, Peru and Venezuela.

Please see Supplementary Information on Oil and Gas Producing Activities in our audited consolidated financial statements for further details on our proved reserves.

Refining, Transportation and Marketing

Summary and Strategy

Our refining, transportation and marketing business segment encompasses the refining, transportation and marketing of crude oil, oil products and fuel alcohol, including investments in petrochemicals.

We own and operate 11 refineries in Brazil, with total processing capacity of 1.99 million barrels per day. There are only two other competing refineries in Brazil, which have an aggregate installed capacity of approximately 0.03 million barrels per day. Our domestic refining capacity constitutes 98.5% of the Brazilian refining capacity. We built nine of our 11 refineries prior to 1972, and we completed the last refinery (Henrique

Lage) in 1980. At that time, we were only producing 200 Mbpd of crude oil in Brazil. Our refineries were built to process light imported crude oil. Subsequent to their completion, we discovered large reserves of heavier crude oil in Brazil. As a result, we are continually upgrading and improving our refineries to process heavy crude oil.

We approved initial studies for construction of a new refinery in the Northeast of Brazil. With an estimated investment of U.S.$2.5 billion in the industrial complex of Porto de Suape, in the state of Pernambuco. The refinery will have the capacity to process 200 Mbpd of heavy oil with the start of operations planned for 2011.

We process as much of our domestically produced crude oil as possible through our refineries, and supply the remaining demand within Brazil by importing crude oil (which we also process in our refineries) and oil products. As our own domestic production increases and refinery upgrades enable us to process more throughput efficiently in the next few years, we expect to import proportionately less crude oil and oil products. Until January of 2002, we were the sole supplier of oil products to the Brazilian market. Now that we are no longer the sole supplier of oil products to the Brazilian market, we intend to reevaluate our import strategy and may reduce imports to the extent such reductions improve our profitability. We also export, to the extent that our production of oil products exceeds Brazilian demand or our refineries are unable to process the growing domestic crude oil production.

We transport oil products and crude oil to domestic wholesale and export markets through a coordinated network of marketing centers, storage facilities, pipelines and shipping vessels. As the single supplier for almost fifty years of a country that ranks as the 12th largest oil-consuming nation in the world, according to the June 2005 issue of *Statistical Review of the World*, we have developed a large and complex infrastructure. Our refineries are generally located near Brazil s population and industrial centers and near our production areas, which creates logistical efficiencies in our operations.

In accordance with the requirements of the Oil Law, we have placed our shipping assets into a separate subsidiary, Petrobras Transporte S.A., or Transpetro. This subsidiary leases storage and pipeline facilities and provides open access to these assets to all market participants. Our petrochemicals business is now also included in the refining, transportation and marketing segment.

Our main strategies in refining and transportation are to:

- strenghthen solution and relationship processes to the client, by understanding the client s value chain and adjusting the services and products portfolio;
- expand processing, transporting and commercialization activities, using bio-energy sources and raw material produced by us;
- diversify our business portfolio, focusing on synergy among assets;
- expand activities in the petrochemical and fertilizer industries, by seeking strategic partnerships and promoting synergies with our other operations;
- improve efficiency in all stages of logistic processes by using a variety of transportation systems and focusing on operational excellence, safety standards and high quality services; and
- apply state of the art technology on oil processing to promote energy and environmental efficiency.

Our refining, transportation and marketing results are reflected in the Supply segment in our audited consolidated financial statements.

Refining

At December 31, 2005, we had total installed refining capacity of 1.99 million barrels per day, which, according to *Petroleum Intelligence Weekly*, made us the 8th largest refiner of oil products in the world among publicly traded companies in 2005. Worldwide, we processed an average of 1.69 million barrels of crude oil per day

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in 2005, which represents a utilization rate of 84.9% for the year, calculated over total capacity. This compares with an 85% average utilization rate in 2004 and an 81% average utilization rate in 2003.

Our domestic production in 2005 supplied approximately 80% of the crude oil feedstock for our refinery operations in Brazil, as compared to 76% in 2004 and 80% in 2003. We expect an increasing percentage of the crude oil feedstock to be supplied by our relatively lower cost domestic production, as our overall domestic production increases. Because our domestic refining capacity constitutes 98.5% of the Brazilian refining capacity, we supply almost all of the refined product needs of third-party wholesalers, exporters and petrochemical companies, in addition to satisfying our internal consumption requirements with respect to wholesale marketing operations and petrochemical feedstock.

Our refineries are located throughout Brazil, with heavy concentration in the Southeast where demand for domestic products is greatest, due to significant industrial activity and large population centers. Most of our refineries are located near our crude oil pipelines, storage facilities, refined product pipelines and major petrochemical facilities. This configuration facilitates access to crude oil supply and major end-user markets in Brazil.

Refinery Production and Capacity

In Brazil in 2005, we processed a total of 633 million barrels of crude oil or on daily basis 1.69 million barrels per day. Our Brazilian production supplied approximately 80% of this crude oil. Our average refining costs (consisting of variable costs and excluding depreciation and amortization) in Brazil were U.S.$1.90 per barrel in 2005, U.S.$ 1.38 per barrel in 2004 and U.S.$1.17 per barrel in 2003. Due to the heavier crude characteristic of many Brazilian fields, we have invested in equipment for conversion of heavy crude oil into lighter products. The majority of our heavy crude conversion capacity is located in our refineries: Landulpho Alves, Duque de Caxias, Paulínia, Presidente Bernardes, Gabriel Passos and Henrique Lage. The following table describes the installed capacity, refining throughput and utilization factor of our refineries for each of 2005, 2004 and 2003:

REFINING STATISTICS

	2005			2004			2003		
Refineries	**Capacity (Mbpd)**	**Throughput[1] (Mbpd)**	**Utilization[2] (%)**	**Capacity (Mbpd)**	**Throughput[1] (Mbpd)**	**Utilization[2] (%)**	**Capacity (Mbpd)**	**Throughput[1] (Mbpd)**	**Utilization[2] (%)**
Paulínia	365	320	88%	365	351	96%	365	297	81%
Landulpho Alves (9)	332	249	75	323	237	73	323	200	62
Duque de Caxias (9)	275	242	88	242	230	95	242	214	88
Henrique Lage	251	241	96	251	236	94	251	219	87
Alberto Pasqualini(3)	189	116	61	189	103	54	189	105	56
Pres. Getúlio Vargas(4)	189	186	98	189	165	87	189	191	101
Pres. Bernardes	170	157	92	170	154	91	170	164	96
Gabriel Passos	151	131	87	151	132	87	151	129	85
Manaus	46	44	96	46	45	98	46	44	96
Capuava	53	35	66	53	46	87	53	44	83
Fortaleza	6	5	83	6	5	83	6	5	83
Total Brazilian (9)	2,027	1,726	85	1,985	1,704	86	1,985	1,612	81
Gualberto Villarroel(5)	40	25	63	40	22	55	40	18	45

Ricardo Eliçabe(6)	31	26	84	31	30	98	31	30	97
Guillermo Elder Bell(5)	20	16	80	20	16	80	20	15	75
San Lorenzo (7)	38	37	97	38	33	89	38	33	87
Del Norte (8)									
Total International	129	104	81	129	101	78	129	96	74
Total	2,156	1,830	85%	2,114	1,805	85%	2,114	1,708	81%

(1) Throughput does not include slop or any reprocessed feedstock.

(2) Utilization was calculated based on crude oil and NGL only.

(3) We do not own 100% of this refinery.

(4) Because of improvements to the crude plant of this refinery, its output can now slightly exceed the nameplate capacity originally registered with and acknowledged by the National Petroleum Agency in Brazil in 2003.

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(5) Located in Bolivia. We expect that our participation in this refinery will be reduced as a result of the Bolivian nationalization program announced on May 1, 2006.

(6) Located in Argentina.

(7) Located in Argentina. We acquired this refinery through our acquisition of Petrobras Energía, formerly Perez Companc.

(8) Located in Argentina. Del Norte statistics are not included since we own just 28.5% of that refinery.

(9) Includes NGL Capacity (Mbpd): Landulpho Alves = 9, Duque de Caixas = 33.

We operate our refineries, to the extent possible, to satisfy Brazilian demand. Brazil demands a proportionally high amount of diesel, relative to gasoline, which together represent more than half of our production. Because we operate refineries to maximize the output of diesel fuel for which demand in Brazil is greater than our internal production, we produce volumes of gasoline and fuel oil in excess of Brazilian demand and such excess must be exported.

Brazil s demand for oil products has been relatively constant for the last three years, but we continue to increase our refinery throughput, thereby reducing the amount of products we must import to satisfy demand. We have also increased our exports of refined products. The following table sets forth our domestic production volume for our principal oil products for each of 2005, 2004 and 2003**:**

DOMESTIC PRODUCTION VOLUME OF OIL PRODUCTS

	2005 (Mbpd)	%	2004 (Mbpd)	%	2003 (Mbpd)	%
Product						
Diesel	660.1	38.0%	657.0	38.7%	623.4	38.0%
Gasoline	324.5	18.7	292.8	17.3	290.9	17.8
Fuel oil	257.8	14.9	279.9	16.5	266.4	16.2
Naphtha and jet fuel	218.5	12.6	220.2	13.0	219.6	13.4
Other	274.3	15.8	245.7	14.5	238.6	14.6
Total	1,735.2	100.0%	1695.6	100.0%	1,638.9	100.0%

Refinery Investments and Improvements

In recent years, we have made investments in our refinery assets in order to improve yields of middle and lighter distillates, which typically generate higher margin sales and reduce the need to import such products. Our principal strategy with respect to refinery operations is to maximize throughput of domestic crude oil. Since the heavy domestic crude oil produces a higher proportion of fuel oil for each barrel of crude oil processed, production of fuel oil is expected to remain relatively constant as throughput of additional Brazilian crude oil offsets new investment in conversion capacity and the production of coke which can be converted into middle distillates products.

We plan to invest in refinery projects designed to:

- enhance the value of Brazilian crude oil by increasing capacity to refine greater quantities of heavier crude oil that is produced domestically;
- increase production of oil products demanded by the Brazilian market that we currently must import, such as diesel;
- improve gasoline and diesel quality to comply with stricter environmental regulations currently being implemented; and
- reduce emissions and pollutant streams.

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Major Refinery Projects

Included in our Strategic Plan are a number of upgrades to key refineries. Our major investments are generally (1) coker to further break down heavy oil into middle distillates or (2) hydro treatment units that reduce sulfur to produce products that meet international standards. We believe our hydro-treatment units will make it possible to offer diesel fuel containing a maximum sulfur content of 0.05% (starting in 2012), thus meeting stricter environmental standards being implemented under Brazilian law. The principal refineries and planned investments (2006 2010) are as follows:

Refinery	Objective
Alberto Pasqualini (REFAP)	Expansion and modernization of refinery, including the installation of a coker, residue fluid cat. craking unit, and upgrade gasoline and diesel quality.
Presidente Getúlio Vargas Refinery (REPAR)	Installation of coker, expansion of existing refinery unit and units to upgrade the quality of diesel and gasoline.
Henrique Lage (REVAP)	Installation of coker and units to upgrade the quality of diesel and gasoline.
Paulínia Refinery (REPLAN)	Upgrade the quality of diesel and gasoline.
Landulpho Alves (RLAM)	Expansion of existing refinery unit and units to upgrade the quality of diesel and gasoline.
Duque de Caxias Refinery (REDUC)	Expansion of existing refinery, installation of a coker and units to upgrade the quality of diesel and gasoline.
Gabriel Passos Refinery (REGAP)	Expansion of the coker and upgrade the quality of diesel and gasoline.
Presidente Bernardes Refinery (RPBC)	Upgrade the quality of gasoline.
Capuava Refinery (RECAP)	Upgrade the quality of diesel and gasoline.

Imports

During 2005 we continued to import crude oil and oil products because domestic production was not sufficient to satisfy Brazilian demand for certain products. In addition, because the bulk of our domestic reserves consist of heavy crude oil, we need to import lighter crude oils to create an adequate mix of oils to satisfy Brazilian demand and to permit refining by our refineries.

Imported crude oil is transferred into our refineries for storage and processing, with a small percentage being sold to the other two Brazilian refiners. Imported oil products are sold to the retail market in Brazil through distributors, including our subsidiary BR.

The average daily volume of our imports of crude oil has decreased to 352 Mbpd in 2005, as compared to 450 Mbpd in 2004 because of the increase in domestic crude oil production. Part of such increase was allocated to our refineries as result of an improvement of heavy oil conversion capacity and part was allocated to crude oil exports.

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The following table sets forth the percentage of crude oil that we imported during each of 2005, 2004 and 2003 by region.

IMPORTS OF CRUDE OIL BY REGION

	2005	2004	2003
		Volume (%)	
Region			
Africa	67.5%	73.4%	63.7%
Middle East	29.4	24.2	30.9
Central and South America/Caribbean	3.1	2.4	3.1
Oceania	0.0	0.0	0.9
Europe	0.0	0.0	1.4
Total	100.0%	100.0%	100.0%

In 2005, our total costs of imports of crude oil from all these regions was U.S.$6,035 million, as compared to U.S.$5,191 million in 2004 and U.S.$3,541 million in 2003.

We purchased approximately 19.4%, 17.7% and 23.4% of our crude oil imports in 2005, 2004 and 2003, respectively, pursuant to one-year term contracts, which are considered to be long-term contracts within the industry standard practice. We are also a significant buyer of crude oil and oil products from suppliers in the international spot market.

Imports of oil products also decreased to 95 Mbpd in 2005, as compared to 110 Mbpd in 2004 and 122 Mbpd in 2003, primarily as a result of the increase in domestic production. LPG decreased due to replacement by natural gas, and increase in the production as a result of the revamping of the refineries and an increase in production due to the addition of FCC catalizer additives. For distillates, the decrease in the imported amounts is a result of the increase in our processing capacity. For naphtha the increase is a result of imports of light naphtha used in oil chains. The following table sets forth the volume of oil products imported during each of 2005, 2004 and 2003:

IMPORTS OF OIL PRODUCTS

	2005	2004	2003
		Volume (Mbbl)	
Oil Product			
LPG	6,268	11,537	12,034
Distillates(1)	16,740	16,879	23,183
Naphtha	8,243	7,231	5,026
Others(2)	3,523	4,487	4,225
Total	34,774	40,134	44,468

(1) Includes gasoline, diesel fuel and some intermediate fractions.

(2) Includes Algerian NGLs, fuel oil, Ethanol,

Methanol and others.

In 2005, total costs of oil product imports, measured on a cost-insurance-and-freight basis, was U.S.$2,108 million, as compared to U.S.$1,721 million in 2004 and U.S.$1,542 million in 2003. For a discussion of import purchase volumes and prices, see Item 5. Operating and Financial Review and Prospects Sales Volumes and Prices Import Purchase Volumes and Prices.

Exports

We also export that portion of oil products processed by our refineries that exceed Brazilian demand. In addition, we export domestic crude oil that we are unable to process in our refineries because of limited conversion capacity. Our total exports increased to 214 MMbbl in 2005 from 186 MMbbl in 2004 as a result of the increase in production of domestic crude oils and the decrease in the local demand for inferior environmental quality products. The following table sets forth the volumes of oil products we exported during each of 2005, 2004 and 2003:

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EXPORTS OF OIL AND OIL PRODUCTS(1)

	2005	2004	2003
		(Mbbl)	
Crude Oil	96,155	66,319	84,899
Fuel Oil (including bunker fuel)	63,896	107,104	85,740
Gasoline	17,240	11,510	13,656
Other	9,716	1,288	8,250
Total	187,007	186,221	192,545

(1) The figure includes sales made by PIFCo to unaffiliated third parties, including sales of oil and oil products purchased internationally.

The total value of our crude oil and oil products exports, measured on a free-on-board basis, was U.S$10,086 million in 2005, U.S.$8,938 million in 2004 and U.S.$5,335 million in 2003.

Transportation

The Oil Law requires that a separate company operate and manage the transportation network for crude oil, oil products and natural gas in Brazil, so we created a wholly-owned subsidiary, Transpetro, in 1998 to build and manage our vessels, pipelines and maritime terminals and handle various other transportation activities. In May 2000, Transpetro also took over the operation of our transportation network and storage terminals to comply with legal requirements. As of October 1, 2001, with the approval from the ANP, these pipelines and terminals were leased to Transpetro, which started to offer its transportation services to us and to third parties. As the owner of the facilities leased to Transpetro, we retain the right of preference for its shipments, based on the historical level of transportation assessed for each pipeline, formally assigned by the ANP. The excess capacity is available to third parties on a non-discriminatory basis and under equal terms and conditions.

Prior to the enactment of the Oil Law, we were the only company authorized to ship oil products to and from Brazil and to own and operate Brazilian pipelines. Additionally, only vessels flying the Brazilian flag were entitled to carry shipments to and from Brazil. Pursuant to the Oil Law, the ANP now has the power to authorize any company or consortium organized under Brazilian law to transport crude oil, oil products and natural gas for use in the Brazilian market or in connection with import or export activities, and to build facilities for use in any of these activities. The Oil Law has also provided the basis for open competition in the construction and operation of pipeline facilities.

Pipelines and Terminals

We own, operate and maintain an extensive network of crude oil and natural gas pipelines connecting our terminals to refineries and other points of primary distribution throughout Brazil. At December 31, 2005, our onshore and offshore crude oil and oil products pipelines totalled 6,245 miles or 10,048 kilometers in length, our natural gas pipelines aggregated approximately 5,705 miles or 9,179 kilometers in length, including the Brazilian side (1,612 miles or 2,593 kilometers) of the Bolivia-Brazil pipeline, and our flexible pipelines totalled 1,804 miles or 2,902 kilometers in length.

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NATURAL GAS PIPELINES IN BRAZIL

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CRUDE OIL AND OIL PRODUCTS PIPELINES IN BRAZIL

In March 2005, we signed all of the financing documents for the *Plano Diretor de Escoamento e Tratamento* (PDET) project originally designed to enhance our crude oil transportation system extending from the most productive fields, located in the Campos Basin, to the refineries located in the Southeast region of Brazil.

At the end of 2003, change in State of Rio de Janeiro Legislating required evaluation of economic feasibility of the original concept of the onshore portion of PDET. After that, we announced the cancellation of the onshore portion of the PDET project and a revision to the project s original design.

Under the revised project, the original offshore fixed platform (PRA-1) will be connected to five offshore production platforms through pipelines and will transfer the crude oil to a floating, storage and offloading platform (FSO) and two monobuoys, which will in turn facilitate the transfer of the crude oil to shuttle tankers or the export of the crude oil to other countries. The shuttle tankers will transport the oil to the Southeast terminals where it will be pumped to existing onshore pipelines connected to refineries in Rio de Janeiro, Minas Gerais and São Paulo. The PDET project will cost approximately U.S.$760 million and is expected to start its commercial operation in the first quarter of 2007. This project will permit to increase the flow of oil produced in the Campos Basin by up to 630 Mbpd.

Transpetro also operates 44 storage terminals with nominal aggregate capacity of 65.0 million barrels of oil equivalent. At December 31, 2005, tankage capacity at these terminals consisted of 35.2 million barrels of crude oil, 27.3 million barrels of oil products and fuel alcohol and 2.5 million barrels of LPG. In 2005, Transpetro began to operate a new storage terminal (TNC Norte Capixaba Terminal) with the nominal tankage capacity of 491 M barrels.

Transpetro is currently evaluating alternatives to improve the efficiency of its transportation system, including improvements to the monitoring and control of the pipeline network through the gradual implementation of a supervisory control and data acquisition system, which, when completed, will monitor the pipelines and storage facilities located throughout the country.

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Transpetro implemented the first phase of the project and inaugurated a centralized control and operating center in June 2002, in its headquarters in Rio de Janeiro. Currently, there are a national back-up master station and two regional master stations connected through satellite communication. Tank-farms and pump stations are equipped with mini stations connected to the regional master stations. Transpetro s goal is to be able to operate all of its domestic pipelines remotely, initially via the regional stations, and ultimately via the centralized control and operating center located in its headquarters in Rio de Janeiro. In 2005, the Centralized Control and Operating Center began to operate a new gas pipeline, GASCAB III. We will continue to develop this project. In addition, Transpetro has been investing in the development of a pipeline integrity program (*Programa de Integridade de Dutos)* to ensure the integrity and safety of its pipelines operations.

Shipping

At December 31, 2005, our fleet consisted of the following 52 vessels (46 owned and 6 bareboat chartered), 32 of which are single hulled and 20 of which are double hulled:

OWNED/BAREBOAT CHARTERED VESSELS

	Number	**Capacity (deadweight tonnage in thousands)**
Type of Vessel		
Tankers	44	2,443.4
Liquefied petroleum gas tankers	6	40.2
AHTS Anchor Handling Tug Supply	1	2.2
FSO Floating, Storage and Offloading	1	28.9
Total	52	2,514.7

These vessels are currently operated by Transpetro and their activities are mainly concentrated in the Brazilian coastline, South America (Venezuela and Argentina), Mediterranean Sea, Caribbean Sea, Gulf of Mexico, West Africa and the Persian Gulf. The single-hulled ships only operate in areas where environmental legislation permits, including Brazil, Venezuela, Argentina and the West Coast of Africa. The double-hulled ships operate in other international locations in accordance with applicable laws. Our shipping operations support the transportation of crude oil from offshore production systems, our import and export of crude oil and oil products and our coastal trade. Our Business Plan calls for investment of U.S.$1.0 billion to renew our fleet, by adding 53 vessels by 2015. The table below sets forth the types of products and quantities of such products we transported during each of the years indicated.

PRODUCTS AND QUANTITIES TRANSPORTED

	2005	**2004**	**2003**
		(millions of tons)	
Product			
Crude oil	92.38	88.4	96.6
Oil Products	40.42	34.0	28.1
Fuel Alcohol	0.04		
Total	132.84	122.4	124.7
Percentage transported by our owned/bareboat chartered fleet	43%	45.1%	45.3%
Coastal transport as a percentage of total tonnage	67%	61.1%	64.2%

The average monthly-chartered tonnage in 2005 amounted to 5.9 million deadweight tons, as compared to 4.6 million deadweight tons in 2004 and 4.0 million deadweight tons in 2003. The chartered tonnage is continuously adjusted to our needs for overall market supply cost reduction. Our aggregate annual cost for vessel charters was U.S.$972.01 million in 2005, U.S.$701 million in 2004 and U.S.$537 million in 2003.

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Petrochemicals

We conduct petrochemical activities with the exception of naphtha sales through our subsidiary, Petrobras Química S.A., or Petroquisa. Petroquisa is a holding company with interests in nine operational petrochemical companies involved in the production and sale of basic petrochemical products and utilities. At December 31, 2005, our ownership percentage of the total capital of these investees ranged from 8.45% to 85.04% and our ownership percentage of the voting capital of these investees ranged from 10.02% to 70.45%. The total book value of these investments was U.S.$820 million on December 31, 2005. Most of such interests are minority voting interests.

The basic supply feedstock used in Brazil s petrochemical industry is naphtha . Until 2001, we were the sole supplier of naphtha to Brazil s petrochemical industry. Following regulatory change in 2002, the petrochemical industry began importing naphtha directly. In 2005, the industry imported approximately 35.6% of its naphtha needs, and we supplied the remainder from our refining operations.

The shareholder equity in the affiliate companies of the petrochemicals business increased by U.S.$12 million between 2004 and 2005. We currently expect to maintain a presence in the petrochemicals industry principally by participating in projects integrated with our refineries. We expect that our selective investments in petrochemicals will consolidate our involvement in the entire value chain and will help integrate our basic and refining products. Although we have divested certain interests in the petrochemical segment in the past, we plan to increase the current level of investments, as part of our downstream strategy.

In line with our strategy of stimulating demand for natural gas products, we also continue to invest in Rio Polímeros S.A.,(Gas Chemical Complex). Located next to our Duque de Caxias Refinery (REDUC). The complex has a nominal plant capacity of 540,000 tons per year of polyethylene and 79,000 tons per year of propylene produced from ethane and propane extracted from natural gas originated in the Campos Basin. In addition to Petroquisa, the three other investors are BNDESPAR and two leading private Brazilian petrochemical companies, Suzano and Unipar. Petroquisa holds a 16.7% interest of the voting and preferred capital in Rio Polímeros. Of the approximately U.S.$1.08 billion budgeted construction cost, 60% is being provided by long-term loans from, or guaranteed by, U.S. Ex-Im Bank, BNDES (the Brazilian Federal Development Bank) and SACE (the Italian Export Credit Agency), and 40% is funded by equity investments. Rio Polímeros has been in operation since late 2005. In the first quarter of 2006, the Contractor ran reliability and performance tests in order to reach the guaranteed acceptance level and operational stage. On March 31, 2006 the test and commissioning phase of Rio Polímeros was concluded.

According to our 2006-2010 Business Plan, we intend to spend approximately U.S.$2.0 billion in capital expenditures in our Brazilian petrochemicals operation. Such investment will be aimed at increasing production of basic petrochemicals, including polyolefins (polyethylene and polypropylene), acrylic acid and terephtalic acid. These projects will be carried out with other partners. Additionally, the preliminary technical and economic feasibility studies carried out by Petrobras identified the construction of a basic petrochemical complex as an important opportunity. This complex would integrate refinery units and petrochemical facilities to produce petrochemical raw materials like ethylene, propylene, aromatics and its petrochemical derivatives, like polyethylene and polypropylene, in order to supply the growing demand for such products in the Brazilian market. We are currently evaluating the conceptual project for this petrochemical complex. On March 28, 2006 we defined that the Petrochemical Complex of Rio de Janeiro will be built on the border of Itaboraí and São Gonçalo, in the State of Rio de Janeiro, with capacity to process 150 Mbpd and produce petrochemical raw material in the following quantities: 1,3 million tons/year of ethylene, 0.9 million tons/year of propylene, 0.36 million tons/year of benzene, 0.7million tons/year of p-xylene and oil derivatives such as 0.7 million tons/year of coke and small amounts of diesel oil and naphtha. The total global investment is estimated to reach U.S.$6.5 billion, including the second generation units, polyethylenes, polypropylene, styrene and ethylene-glycol. The complex is expected to be operating in 2012.

On April 29, 2005, Odebrecht, Norquisa and ODBPAR (the Odebrecht Group) and Petroquisa entered into a second amendment to the memorandum of understanding under which Petroquisa had an option to acquire an amount of Braskem voting shares sufficient to increase its existing participation in Braskem to up to 30% of Braskem voting share capital (which we refer to as Option Shares). Such memorandum also eliminated the restriction on Petroquisa from owning interests in other petrochemical companies or projects following its possible exercise of the option. On March 31, 2006, after appraisals carried out by the concerned parties, Petroquisa decided

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not to exercise the Option Shares, as the parties were not able to reach a consensus regarding the terms and conditions for this exercise. The current shareholding structure of Braskem will not suffer any change, as the shareholding position currently held by Petroquisa of 10.02% in the voting capital and 8.45% in the total share capital of Braskem will be maintained, as well as the provisions of the Memorandum of Understanding for a Shareholders Agreement of Copene Petroquímica do Nordeste S.A. (the former name of Braskem), signed by Odebrecht and Petroquisa.

On September 16, 2005, Petroquisa and Braskem incorporated Petroquímica Paulínia S.A. PPSA, a joint venture between the two companies, contributing 40% and 60% of the entity s capital, respectively. PPSA s purpose is to implement a polypropylene unit in Paulínia-SP and to use a polymer-grade propylene supplied by us as raw material for its operations, with capacity of 300 thousand tons per year and a global investment estimated at U.S.$240 million. The commercial operations are projected to begin in the first quarter of 2008. To date, Petroquisa has invested R$3 million.

On November 28, 2005, Petroquisa, Mossi & Ghisolfi and Citene signed a Memorandum of Understanding in which Mossi & Ghisolfi and Citene agreed to conduct a feasibility study relating to the development of a Purified Terephthalic Acid Plant in Pernambuco. The study showed favorable results. In March of 2006, Petroquisa and Citene signed a new memorandum regarding the creation of a company to implement the project and Mossi & Ghisolfi withdrew from the project. Petroquisa and Citene are considering whether to involve a new partner in the project and are currently negotiating the joint venture, which will be responsible for the development of the project. The plant will have a capacity of 550 thousand tons per year. We are projecting that an investment of U.S.$492 million through 2009 will be required for this project, as an estimate of the start-up costs of the plant through 2009.

On April 17, 2006, our Board of Directors approved the incorporation of all outstanding shares of Petroquisa. Currently, we hold approximately 99% of Petroquisa s capital stock and the remaining 1% is dispersed among minority shareholders. The main purpose of the share incorporation is to align the strategic interests of both companies. Under the terms of the incorporation, each lot of 1,000 common or preferred shares issued by Petroquisa will be exchanged for 4,496 preferred shares of our Company. As a result of such incorporation, we will issue 886,670 new preferred shares. In accordance with Brazilian Corporation Law, the share incorporation is still subject to approval by the shareholders of both companies, and the dissenting shareholders of Petroquisa have the right to withdraw.

Distribution

Summary and Strategy

Through Petrobras Distribuidora S.A., or BR, we distribute oil products and, fuel alcohol to retail, commercial and industrial customers throughout Brazil. Our operations are supported by tankage capacity of approximately 14.6 million boe, at 111 storage facilities and 96 aviation product depots at airports throughout Brazil.

Our main strategies in distribution and marketing are to:

- be the preferred brand of the consumer, with a multi-business retail network that offers excellence in the quality of products and services, expanded leadership and guaranteed expected profitability; and
- add value to our system, by being the leader in all consumer market segments, launching new products, services and innovative solutions and by assuring the preference for our brand.

As of 2005, Liquigás Distribuidora became the official name of our liquefied petroleum gas (*gás liquefeito de petróleo*, or LPG) distribution company, previously called Agip do Brasil S.A. and Sophia do Brasil S.A. Agip do Brasil S.A. was acquired in August 2004 to expand our participation in the LPG distribution sector and to consolidate our presence in the distribution market. By the end of 2005, Liquigás Distribuidora held a 21.8% market share and ranked third in the LPG distribution market based on sales volume according to Sindigás (*Sindicato Nacional das Empresas Distribuidoras de Gás Liqüefeito de Petróleo*).

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In 2005, we sold 173.9 million barrels of oil products to wholesale customers, with gasoline and diesel fuel representing approximately 85% of these sales. Of our total sales in 2005, 157.8 million barrels of oil products were supplied to BR for retail marketing. The following table sets forth our oil product sales to wholesale customers and retail distributors for each of 2005, 2004 and 2003:

OIL PRODUCT SALES

	2005	2004	2003
		(MMbbl)	
Product			
Diesel	228.1	224.9	208.3
Gasoline	114.3	104.8	101.8
Fuel oil	77.2	106.1	98.5
Naphtha and jet fuel	79.3	81.5	76.6
Others	343.5	129.1	283.2
Total	842.4	646.4	768.4
Customer			
Wholesalers			
Diesel	105.5	106.6	100.2
Gasoline	43.0	42.9	41.0
Others	25.4	25.6	26.0
Total wholesalers	173.9	175.1	167.2
Retail distributors			
BR	157.8	145.1	133.6
Third parties	510.7	326.2	467.6
Total retail distributors	668.5	471.3	601.2
Total customers	842.4	646.4	768.4

Retail

As of December 31, 2005, our sales network in Brazil included 6,933 retail service stations compared to 6,785 as of December 31, 2004, and comprised approximately 24.5% of the total number of service stations in Brazil, all under the brand name BR. Over 50% of these BR stations are located in the South and Southeast regions of Brazil, where over 59% of Brazil s total population of 180 million reside. Of these 6,933 service stations, 5,885 were active stations and BR owned 763. As required under Brazilian law, BR subcontracts the operation of all its service stations to third parties. The other 6,170 service stations were owned and operated by dealers, who use the BR brand name under license with BR facilities as their exclusive suppliers. BR provides technical support, training and advertising for its network of service stations.

In 2005, 295 of our service stations also sold vehicular natural gas, compared to 245 in 2004 and 204 in 2003. The sales from these stations consisted of 17,208 million cubic feet (487 million cubic meters) in 2005, representing 25.1% of Brazilian market share, 15.005 million cubic feet (425 million cubic meters) in 2004, representing 27% of Brazilian market share and 14,554 million cubic feet (412 million cubic meters) in 2003, representing 31.2% of Brazilian market share.

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The table below sets forth market share (based on volume) for retail sales of different products in Brazil for each of 2005, 2004 and 2003:

BR MARKET SHARE IN DISTRIBUTION

	2005	2004	2003
Fuel oil	64.8%	64.4%	65.2%
Diesel	31.9	28.6	26.1
Gasoline	25.0	22.1	21.1
Fuel alcohol	32.2	31.2	33.3
Total	33.8%	31.6%	30.8%

Prices to retailers have generally tended to remain consistent between competing distributors, particularly due to the low margin in the sector. Therefore, competition among distributors continues to be primarily based on product quality, service and image.

During 2005, approximately 27% of the retail sales at service stations in Brazil were made through BR-owned or franchised entities. We believe that our market share position has remained strong over the past several years due to the strong brand name recognition of BR, the remodeling of service stations and the addition of lubrication centers and convenience stores.

In 1996, BR created the *De olho no Combustível* program (Eye on the Fuel program), which is a certification program designed to ensure that the fuels sold to end consumers at service station networks are identical in content to the fuels originating from our refineries. We have already certified 4,496 service stations under this program.

The retail market for gasoline and diesel fuel in Brazil is highly competitive and we expect that prices will be subject to continuing pressure. Accordingly, we intend to build upon the strong brand image that we have established in Brazil to enhance profitability and customer loyalty. We plan to take the following actions through 2010:

- selectively expand our service stations network, reinforcing the Petrobras image;
- increase the use of client fidelity programs and new technologies; and
- reduce operating and administrative costs and provide services, such as financial services and controls, through investments in advanced telecommunications and data processing technology.

We participate in the retail sector in Argentina, where we currently own 746 retail service stations that operate under the brand names Petrobras (451 stations), Eg3 (248 stations) and San Lorenzo (47 stations). We also have a participation in the retail sector in Bolivia, Colombia, Paraguay and Uruguay, with 104, 39, 131 and 89 retail service stations respectively.

Commercial and Industrial

We distribute oil products to commercial and industrial customers through BR. Our major customers are aviation, transportation and utility companies and government entities, all of which generate relatively stable demand. We have a market share in the commercial and industrial distribution segment in excess of 33.8% which has remained relatively constant over the past several years.

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Set forth below are commercial and industrial sales statistics for each of 2005, 2004 and 2003:

COMMERCIAL AND INDUSTRIAL RETAIL SALES BY PRODUCT

	For the Year Ended December 31,		
	2005	2004	2003
		(Mboe)	
Fuel oil	22,850	24,649	27,729
Diesel	78,241	70,521	60,117
Gasoline	36,690	32,147	28,710
Jet fuels	15,784	15,020	14,343
Fuel alcohol	5,132	4,147	3,286
Lubricants	1,601	1,460	1,256
Others	24,943	22,609	23,198
Total	185,241	170,554	158,638

Natural Gas and Power

Summary and Strategy

Our natural gas and power activities encompasses the purchase, sale and transportation of natural gas produced in or imported into Brazil. Additionally, this segment includes our domestic electric energy commercialization activities as well as participation in domestic natural gas transportation companies, state-owned natural gas distributors and gas-fired power plants.

The natural gas market in Brazil has been growing steadily. The Brazilian government estimated that, in 2005, natural gas consumption represented approximately 9,3% of primary energy use, as compared to 8,9% in 2004 and 7,7% in 2003. In addition, the Brazilian government estimates that natural gas will represent 11% of primary energy use by 2010. We expect that a portion of this growth will come from increased industrial demand as well as from the replacement of fuel oil by cleaner energy sources. The development of natural gas-fired power plants in Brazil will also add growth to the natural gas market. During the last three years, industrial consumption of natural gas has increased at a compounded annual growth rate of 8.0% while vehicular consumption has increased approximately 13,2%. In 2005, industrial and vehicular consumption have grown 7.15% and 20.2%, respectively.

To capitalize on these growth opportunities, we have adopted a vertically integrated strategy. As a result of our petroleum exploration and production activities in Brazil, we produce significant amounts of associated natural gas as a by-product.

Our main strategies in the natural gas and power segment are to:

- develop the natural gas industry in an integrated manner with other areas of the Company, in Brazil and other South American countries;
- take advantage of growing opportunities in the power industry in an integrated manner with other natural gas market sector in which our Company already operates; and
- develop some renewable energy alternatives and the *Mecanismos de Desenvolvimento Limpo* MDL, or Clean Development Mechanisms, as well as coordinate and implement activities related to energy efficiency to the Petrobras system and final consumers.

Our natural gas and power results are reflected in the Gas and Energy segment in our audited consolidated financial statements.

Natural Gas

Pipelines

We developed and built the Bolivia-Brazil natural gas pipeline, which has a total capacity of 1,060 MMscfd (30 MMcmd). The pipeline is 1,969 miles (3,150 kilometers) in length, running from Rio Grande in Bolivia to Porto Alegre in Southern Brazil. The Bolivia-Brazil pipeline connects to our domestic pipeline system that transports natural gas from the Campos and Santos Basins. This pipeline was designed to supply gas to some of our power and petrochemical plants. See Item 3. Key Information Risk Factors Risks Relating to Our Operations¾ The recent nationalization measures taken by the Bolivian and Venezuelan governments may have an adverse effect on our results of operations and financial condition.

The Cabiúnas project comprises transportation and processing facilities of natural gas from the offshore oil fields in the Campos Basin of the State of Rio de Janeiro. This project has been operational since the second semester of 2005 and increased the transportation capacity from the previous 290 million cubic feet (8.2 million cubic meters) per day to a total of 476 million cubic feet (13.5 million cubic meters) per day of associated gas, while reducing the volumes of natural gas currently flared on offshore platforms and alleviating existing constraints on oil production from these platforms. In 2005, the average daily volume of natural gas flared on the offshore platforms of the Campos Basin was 130.7 million cubic feet (3.7 million cubic meters).

We are currently developing the Southeast and the Northeast Gas Pipeline Networks (*Malha Sudeste* and *Malha Nordeste*). This project, which is known as the Malhas Project, will create additional transportation capacity by expanding the existing natural gas infrastructure and delivering natural gas to markets in the Northeast and Southeast regions of Brazil. This project includes the construction of an approximately 808 miles (1,300 kilometers) pipeline network, which is expected to start operations gradually during the years of 2006 and 2007, at a total cost of approximately U.S.$1.5 billion.

The projected pipeline to deliver natural gas to the state of Amazonas in Northern Brazil (Coari Manaus Gas Pipeline), will have a length of 382 kilometers, and the project to deliver liquefied petroleum gases to the same state (Urucu-Coari LPG Pipeline), will have a length of 279 kilometers.

Local Distribution Companies

We sell natural gas in Brazil to local gas distribution companies, since under Brazilian law, each state has the monopoly over local distribution . Most states have established companies to act as local gas distributors and we have interests in some of these companies.

We appoint the majority of the technical and commercial directors of all distribution companies in which we hold a minority shareholding stake.

In December 2004, Gaspetro acquired a 40% equity interest in Gasmig, the gas distribution company of the State of Minas Gerais, for R$154 million (U.S.$58 million). In connection with this acquisition, we assumed the obligation to construct natural gas pipelines to be financed by Cemig. In July 2005, Gaspetro also increased its participation in CEG-Rio, the gas distribution company of the State of Rio de Janeiro, by acquiring an additional 12.41% of shares of CEG-Rio from Gás Natural SGD for R$39.3 million (U.S.$16.5 million). Gaspetro now holds 37.41% of CEG-Rio s shares.

Currently we hold, through our subsidiary PETROBRAS Gás S.A. GASPETRO, 19 minority interests in natural gas distribution companies in many states of Brazil. However, 5 Companies (CEBGÁS, GOIASGÁS, RONGÁS, GASAP and GASMAR) have not yet started their operations. We are not shareholders in the following companies: MTGÁS, COMGAS, CIGAS, GAS BRASILIANO, SPS and CEG. Also, in the state of Espírito Santo, we have the exclusive rights to distribute natural gas through our subsidiary BR.

In 2005, the gas distribution companies in which we have an interest (ALGÁS, BAHIAGÁS, CEGÁS, CEG-RIO, COMPAGÁS, COPERGÁS, MSGAS, GASPISA, PBGÁS, POTIGÁS, SCGÁS, SERGAS, SULGAS and

GASMIG) held total assets of R$ 2,289 million (U.S.$ 978million) compared with R$2,250 million (U.S.$848 million) in 2004. The assets are mainly an aggregate pipeline extension of 2,654 miles (4,272 kilometers).

Although in 2005 the average volume of gas distribution, of the companies in which we have an interest was almost the same as in 2004 (692 million cubic feet of natural gas per day, or 19.6 million cubic meters per day), the total net operational revenue in 2005 was R$3.467 billion (U.S.$1.481 billion) as compared to R$3.010 billion (U.S.$1.134 billion) in 2004.

The total net income of the companies in which we have an interest increased, and reached R$ 299.0 million (U.S.$ 127.8 million) last year compared with R$ 277.1 million (U.S.$ 104.4 million) in 2004. Such increase resulted from the appreciation of the Brazilian *real* against the U.S. dollar and the increase in the consumption by industrial and vehicular segments, which generate a higher margin, as opposed to gas-fired power plants, in which the use of gas was reduced.

In 2005, investments on the companies in which we have an interest reached a total of R$ 290.8million (U.S.$ 124.2million) compared to R$ 277.3 million (U.S.$ 104.4million) in 2004.

Some of the operating distribution companies in which we have an interest has entered into long term gas supply contracts with us under which such companies have gas purchase obligations (in the case of contracts relating to Brazilian gas), and ship-or-pay and gas purchase obligations (in the case of contracts relating to Bolivian gas or with gas-fired power producers). These ship-or-pay and gas purchase contracts do not allow net settlement by either the buyer or the seller, and no market mechanism exists for net settlement.

The following table sets forth our domestic sales of natural gas to affiliated and non-affiliated local distribution companies for each of 2005, 2004 and 2003:

DOMESTIC SALES OF NATURAL GAS TO LOCAL DISTRIBUTION COMPANIES

	Year Ended December 31,		
	2005	**2004**	**2003**
(in MMscfd)			
Total sales annual average(i)	1,289	1,164	978
Annual sales growth(i)	11%	19%	13.4%

(i) The volume of natural gas sold to local distribution companies (thermal and non-thermal). Our internal consumption and natural gas received by internal transfer are not included.

Commitments and Sales Contracts

Our investment in the Bolivia-Brazil gas pipeline was the result of a 1996 gas supply agreement, or the GSA, for the purchase of natural gas between the Bolivian state oil company, Yacimientos Petrolíferos Fiscales Bolivianos YPFB, and us. The GSA requires us to purchase from YPFB specified quantities of natural gas transported through the pipeline over a 20-year term. See Item 3. Key Information Risk Factors Risks Relating to Our Operations¾ The recent nationalization measures taken by the Bolivian and Venezuelan governments may have an adverse effect on our results of operations and financial condition.

Gas purchase commitments. Under our contracts with YPFB for the purchase of natural gas, we have agreed to purchase minimum volumes of natural gas from Bolivia at a formula price that varies with the price of fuel oil. We have purchased and paid in 2005, 2004 and 2003, approximately U.S.$799 million, U.S.$544 million and U.S.$362 million, respectively. Such increase resulted from higher prices (which reflected the international prices for oil and fuel) and the increase in the imported amounts: 22.96 MM m3/d in 2005, as opposed to 19.94 MM m3/d in 2004 and 14.17 MM m3/d in 2003. During 2002 and 2003 we purchased less than the minimum volumes set under our agreement with YPFB, and therefore we paid a total amount of U.S.$81 million to satisfy our purchase commitment. Set forth below are the minimum volumes we have agreed to under these contracts, together with an estimate of the amounts we are obligated to pay for such minimum volumes:

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NATURAL GAS PURCHASE COMMITMENTS

	2006	2007	2008	2009	2010
Volume Obligation (Mmcmpd)	24	24	24	24	24
Volume Obligation (Mmcfd)	850	850	850	850	850
Estimated Payments (U.S.$ million)(1)	1,025	921	759	654	634

(1) Amounts calculated based on current prices set forth under the agreements projected constant to the future. Prices may be adjusted in the future and actual amounts may vary. Of these amounts, 25.3% are related to Petrobras Bolivia.

In connection with the above gas purchase contract, we entered into a contract, effective October 2002, with a gas producer to reduce the volatility of prices under the gas purchase contract through 2019 the Natural Gas Price Volatility Reduction Contract, or PVRC. The volume covered by the PVRC represents approximately 43% of the anticipated volume under the gas purchase contract. See Qualitative and Quantitative Disclosure about Market Risk Petrobras Commodity Price Risk and Note 23 to our audited financial statements.

Ship-or-pay commitments. In order to support the financing for the Bolivia-Brazil pipeline, we also have entered into unconditional ship-or-pay purchase obligations for the transportation of natural gas with Gás Transboliviano or GTB and Transportadora Brasileira Gasoduto Bolivia-Brasil or TBG, the companies which own and operate the Bolivian and Brazilian portions of the pipeline, respectively. TBG s portion of the pipeline financing is consolidated in our balance sheet. Our volume obligations under the ship-or-pay arrangements are generally designed to meet the gas purchase obligations with respect to our gas purchase contracts with YPFB. The total capacity of 1,060 MMscfd (30 MMcmd) also includes a transportation capacity option of 212 MMscfd (6 MMcmd), valid for a 40-year term. This transportation capacity option was granted to us in consideration for our agreed investment of approximately U.S.$379 million in the Bolivia-Brazil gas pipeline. The total estimated project cost was U.S.$1.9 billion. In 2005, 2004 and 2003, Petrobras made total payments of approximately U.S.$532 million, U.S.$348 million and U.S.$504 million, respectively. Of these amounts, approximately U.S.$473.5 million, U.S.$302 million and U.S.$463 million corresponded, respectively, to payments made to TBG for the transportation of natural gas. Set forth below are the minimum volumes we have agreed to under the ship-or-pay arrangements, together with an estimate (assuming certain changes in the U.S. Consumer Price Index (CPI)) of the amounts we are obligated to pay for such minimum volumes:

NATURAL GAS SHIP-OR-PAY COMMITMENTS

	2006	2007	2008	2009	2010
Volume Commitment (Mmcmpd)(1)	59.51	59.51	59.51	59.51	59.51

Volume Commitment (Mmcfpd)(1)	2,102	2,102	2,102	2,102	2,102
Estimated Payments (U.S.$ million)(1)	487.73	490.57	492.61	494.70	496.75

(1) The figures for TBG and GTB are consolidated.

Natural gas sales contracts. In light of these gas purchase and ship-or-pay obligations, we have entered into or negotiated firm gas sale and ship-or-pay sale arrangements to sell our domestic and international natural gas to local gas distribution companies and gas-fired power plants, most of which we operate and in which we own a minority interest.

The arrangements with the gas-fired power plants are made through contracts with the local distribution companies, which in turn enter into back-to-back arrangements with the gas-fired power plants, and a portion of the gas buyer s payments is usually guaranteed to us by the parent companies of the gas-fired power companies or through financial guarantees. Our total sales of natural gas, which includes sales to gas-fired power companies, for 2005, 2004 and 2003, were approximately U.S.$2,398 million, U.S.$1,876 million and U.S.$1,580 million, respectively. The table below sets forth the commitments by local gas distribution companies and by gas-fired power plants for the firm purchase of volumes of natural gas from us beginning in 2006, together with an estimate of the amounts obligated to be paid for such volumes:

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NATURAL GAS SALES CONTRACTS

	2006	2007	2008	2009	2010
			(in Mmscfd)		
To Local Gas Distribution Companies					
Related parties(i)	585	624	647	668	686
Third parties	494	534	430	423	425
To Power Generation Plants					
Related parties(i)	27	27	55	55	55
Third parties	184	184	184	184	184
Total	1,290	1,369	1,316	1,330	1,350
Estimated Contract Receipts (U.S.$ million)(ii)(iii)	$2,023	$2,111	$1,923	$1,916	$1,985

(i) For purposes of this table, related parties include all local gas distribution companies and power generation plants in which we have an equity interest and third parties refer to those in which we do not have an equity interest.

(ii) Figures show revenues net of taxes. Estimates are based on firm contracts and do not include internal consumption or transfers. Estimated volumes are based on take or pay agreements in our contracts, not maximum sales.

(iii) Prices may be adjusted in the future and actual amounts may vary.

Pricing. On June 1, 2001, the Brazilian government instituted a mechanism which allows a U.S. dollar indexed component of the natural gas pricing mechanism to be passed through to gas-fired power plants for a period of 12 years, pursuant to *Portaria* No. 176 (a joint regulatory act issued by the Ministry of Mines and Energy and the Ministry of Finance), which was updated by *Portaria* No. 234 issued on July 22, 2002. See Regulations of the Oil and Gas Industry in Brazil Price Regulation Natural Gas. This mechanism has enabled us to sell natural gas to a number of gas-fired power plants that were unwilling to purchase natural gas under the prior gas price regulation because it requires the buyer to take the intra-year exchange rate risk. Under the new formula, exchange rate variations are reflected in gas prices annually, while we will be remunerated at market based interest rates for any resulting delay in gas price adjustments.

Power

Brazil currently has an installed electricity generation capacity of approximately 91,314 MW. More than 96% of this capacity is interconnected to form one single integrated system, with approximately 76% of the electricity supplied to that system coming from hydroelectric sources. Consumption of electricity grew annually at a rate of 4.5% during the 1990s. As a result of the rapid growth in electricity demand, combined with the limited investment in the sector during the last two decades and a high dependency on hydroelectric power (and consequently susceptibility to a prolonged drought), we believe substantial additional generation capacity needs to be developed in Brazil. In recognition of the need for such capacity and in order to promote the development of gas-fired power plants, the Brazilian government established the Thermoelectric (gas-fired) Priority Program (PPT).

New Regulatory Model

A new regulatory model for the power sector was introduced on March 16, 2004 with the enactment of the New Industry Model Law. Under the new model, assured energy availability may be sold under regulated contracts or free contracts. Energy availability sold under regulated contracts must be acquired by means of public auctions and energy availability sold under the free market is negotiated freely through bilateral contracts. The new regulatory model also creates incentives for investments in power generation.

The first auction for new power plants was held in December of 2005. We participated in the auction and sold 1,391 MW of energy from our gas-fired power plants with the intention of securing long-term contracts. The contracts represented 42% of the energy sold in the auction.

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Status of Investments

We believe our participation in the construction and development of gas-fired power plants has strategic benefits for our business because:

- our participation in the power sector helps create a market for natural gas made available through our investments in the natural gas business;
- we are able to build inside the fence co-generation plants close to our refineries and other facilities, which provide us with a reliable and inexpensive source of electricity for use in our own refineries; and
- these co-generation plants also produce steam for use by our refineries and in onshore crude oil recovery enhancement projects. The production and consumption of steam reduces the overall costs of generating electricity, making such electricity cost competitive relative to other gas-fired power generation, including new hydroelectric developments.

In addition, we concluded a program for the acquisition of certain gas-fired power plants, in order to mitigate the losses resulting from contractual obligations previously suffered.

The main purpose of these acquisitions is to reduce our financial exposure in connection with these merchant gas-fired power plants. See Financial Exposure.

Financial Exposure

To encourage the development of some of the gas-fired power plants in which we participate with an equity interest, or to which we sell our natural gas, we have entered into agreements to provide economic support to such gas-fired power plants. Our obligations under these agreements were structured as tolling arrangements whereby we agree to provide each of the inputs to produce electricity and operate the plant, as well as off-take the electricity, remunerating the thermoelectric plant at a price that will service capital (equity and debt).

We have only entered into tolling arrangements with gas-fired power plants in which we have an equity interest. Our power commitments under the tolling agreements are as follows:

POWER OFFTAKE PROJECTED COMMITMENTS

PLANT	**2006**	**2007**	**2008**
		(Average MW)	
FAFEN	138	138	138
TermoBahia	186	186	186
Total NE Tolling Arrangements	**324**	**324**	**324**
Ibiritermo	226	226	226
Total S/SE Tolling Arrangements	**226**	**226**	**226**

The total generating capacity in respect of which we have tolling commitments, based upon commitments of projects under construction or in operation, is 550 MW in 2006.

We expect that the electricity we purchase under the tolling agreements will be partly used for demand in our facilities, estimated to be 319 MW in 2006, 362 MW in 2007 and 382 MW in 2008, allocated between the Northeast and South/Southeast regions of Brazil. UTE FAFEN has a power purchase agreement for the sale of electric power to third parties (distributors /concessionaires). By the end of the fourth quarter of 2005, we sold energy availability in auctions coordinated by the MME, by means of energy agreements of 15 years, starting as of 2008, with increasing volumes, reaching 1391 MW in 2010. Our commercial strategy is to continue the sale of our remaining capacity in public auctions to distributors and the sale to large consumers through power purchase agreements.

After the acquisition of UTES Eletrobolt, TermoCeará and Macae Merchant between April 2005 and April 2006, we ended our financial exposure with third parties relating to contingency contributions.

In January 2003, Companhia Paranaense de Energía, or Copel, ceased making its monthly capacity payments to UEG Araucária Ltda. UEGA (an independent gas-fired power producer that initiated operations in September 2002 and which is 60% owned by El Paso, 20% by Copel and 20% by us). In April 2003, UEGA initiated arbitration proceedings before the ICC International Court of Arbitration to recover damages from Copel s default under the Power Purchase Agreement entered into between the two parties. In March 2006, we settleled this claim. At the termination of the contract, the nominal value of the debt, not recognized by Copel, amounted to R$272 million to be recovered against future supplies of gas. As part of the settlement, we will receive from Copel Geração S.A., a subsidiary of Copel, R$150 million in 60 monthly installments beginning January 2010. Copel is a guarantor of this obligation. Under terms of our settlement agreement, we also agreed with Copel s acquisition of El Paso s quotas in UEGA. In addition, we will seek to meet the fuel supply needs for operating UEGA on a best efforts basis from 2006 to 2010. This fuel may be in the form of natural gas or some other alternative energy source. This settlement agreement resolves the existing dispute in relation to the contract for the supply of gas to UEGA.

Renewable Energy Alternative

Our strategy in energy development is based on renewable energy, energy efficiency and the potential gains in carbon credits due to the prevented emissions promoted by these activities.

Renewable Energy

The main projects relating to renewable energy resources are biodiesel production and electricity generation by wind power plants. Our Strategic Plan establishes 481 thousand cubic meters per year of biodiesel availability and 169MW of electrical generation capacity installed, as a target for 2010.

Three biodiesel production plants of 44,000 tons per year will each be installed and we are analyzing investments in wind power plants under the terms of Incentive Program of Brazilian Government for Alternative Energy Sources, or Proinfa. In addition, we have initiated a technical-economical feasibility study regarding the implementation of small hydropower plants in the Northeast.

Sustainable Development

Our actions relating to sustainable energy development in 2005 aimed to evaluate the implementation of eligible projects to obtain carbon credit certificates according to the Clean Development Mechanism (MDL), as well as to propose sales policies regarding these certificates. We have studied the technical viability and necessary baseline methodologies in order to obtain approval for the projects.

Energy Efficiency

The consolidation of our energy use and the enhancement of energy efficiency in our units were the Internal Energy Conservation Program s main activities.

In 2005, there was a relative reduction in the burning of fossil fuels saving approximately 2,700 barrels of equivalent oil per day; a volume that resulted in savings of approximately U.S.$10 million and that prevented emissions of approximately 390 thousand tons of CO_2 in 2005.

In addition, the National Oil and Natural Gas Derivates Rationalization Program, or Conpet, a governmental program coordinated by us, was extended to more than 23% of the vehicles subject to the program, overcoming the mark of 10% established at the beginning of the year. On environmental matters, this performance means that the program prevented the emissions of about 920 thousand tons of CO_2 into atmosphere.

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International

Summary and Strategy

In 2005, approximately 8.0% of our net revenues were generated outside Brazil. We seek to evolve from an integrated oil and gas company in Brazil to an energy industry leader in Latin America and a strong international player.

Currently, we plan to focus our non-Brazilian exploration, development and production activities regionally, in areas where we can successfully exploit our competitive advantages, such as deepwater drilling. We particularly intend to drill off the west coast of Africa and the Gulf of Mexico and onshore in South America. We recently acquired rights to participate in four exploration blocks offshore Angola. We are also expanding our interests in South America in the downstream segment. During 2006, the following new assets were bought: one lubricant plant, service stations and convenience stores in Colombia; service stations and one LPG re-fueling plant in Paraguay; and service stations, one aviation supply facility, one asphalt commercialization plant, and one natural gas distribution company in Uruguay.

We have budgeted U.S.$7.1 billion in capital expenditures for the period from 2006 to 2010 for international investments.

Our main strategies in the international segment are to:

- seek leadership position as an integrated energy company throughout Latin America;
- expand exploration and production operations, in the Gulf of Mexico and Western Africa.
- accelerate monetization of our natural gas reserves;
- expand our international opportunities to grow and diversify our portfolio of international activities;
- broaden the recognition and increase the value of the Petrobras brand name outside Brazil; and
- add value to the production of Petrobras heavy oil.

Our international results are reflected in the International segment in our audited consolidated financial statements.

Exploration and Production

During 2005 we conducted international exploration activities in Argentina, Bolivia, Colombia, Nigeria, the United States and Venezuela. In addition, we are currently performing studies to evaluate blocks where we hold interests in Angola, Argentina, Colombia, Mexico, Nigeria, the United States, Iran, Equitorial Guinea, Tanzania, Turkey and Libya. Production activities were conducted in Angola, Argentina, Bolivia, Colombia, Ecuador, Mexico, Peru, the United States, and Venezuela. Collectively, these activities represented 14.8% of our total capital expenditures for crude oil and natural gas exploration and production. Our capital expenditures for international exploration and development were U.S.$1,067 million for 2005, U.S.$666 million for 2004 and U.S.$428 million for 2003. The following table provides information about the allocation of such expenditures for each of 2005, 2004 and 2003:

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DISTRIBUTION OF CAPITAL EXPENDITURES IN INTERNATIONAL EXPLORATION ACTIVITIES

	2005	2004	2003
Argentina	7.2%	3.1%	5.6%
Bolivia	4.4	0.2	0.7
Colombia	4.6	3.5	4.4
Peru, Ecuador and Venezuela	0.3	2.4	28.7
South America	16.5	9.2	39.4
West Coast of Africa	47.8	52.0	15.6
Gulf of Mexico	33.9	36.8	42.5
Others	1.8	2.0	2.5
Total	100.0%	100.0%	100.0%

Development

Over the past three years, we have participated in the development of a number of fields internationally. These include: four in Colombia (Guando, Rio Ceibas, Yaguara and Santiago), two in the United States (GB 200 and North Coulomb), one in Angola (Block 2), two in Nigeria (Akpo and Agbami), many fields in Argentina concentrated in the Neuquen and Austral basins (most importantly the Medanito, Puesto Hernandez, Rio Néuquen, Santa Cruz I and Santa Cruz II fields), three in Bolivia (San Alberto, San Antonio, and Colpa Caranda), two in Ecuador (Block 18 and Block 31), one in Peru (Lote X) and four in Venezuela (Ortiupano-Leona, Mata, Acema and La Concepción).

In 2005, our net production outside of Brazil averaged 162.8 barrels per day of crude oil and NGLs and 95.9 barrels of oil equivalent of natural gas per day at an average lifting cost of U.S.$2.90 per barrel. The following table provides information on the allocation of our international development activities for each of 2005, 2004 and 2003.

ALLOCATION OF CAPITAL EXPENDITURES IN INTERNATIONAL DEVELOPMENT ACTIVITIES

	2005	2004	2003
Argentina	36.2%	41.9%	62.2%
Peru	8.3	10.9	
Ecuador	16.7	7.4	
Bolivia	1.7	1.5	7.1
Colombia	4.6	6.8	14.3
Venezuela	15.9	28.4	
South America	83.4	96.9	83.8
West Coast of Africa	15.0	1.4	14.7
Gulf of Mexico	1.6	1.7	1.5
Total	100.0%	100.0%	100.0%

Argentine Activities

With the acquisition of 58.6% of PEPSA (formerly Perez Companc), which owned 98.2% of PESA (formerly PECOM Energía S.A.), in 2002, we reinforced our position as an exploration and production leader in South America,. On January 21, 2005, the extraordinary shareholders meetings of PESA, EG3 S.A. (EG3), Petrobras Argentina S.A. (PAR), and Petrolera Santa Fe SRL (PSF), approved the merger of EG3, PAR and PSF into PESA, which was the surviving company. Prior to the merger, we held a 99.6% interest in EG3 and a 100% interest in each of PAR and PSF, through our subsidiary Petrobras Participaciones SL, or PPSL. Pursuant to the merger, PPSL

received 230,194,137 newly issued class B shares of PESA, representing 22.8% of PESA s capital stock. As a result of the merger, PEPSA s ownership interest in PESA declined from 98.21% to 75.8%. Considering our 58.62% participation in PEPSA, we now own a 67.2% total participation in PESA.

As of December 31, 2005, our combined crude oil and natural gas proved reserves in Argentina were approximately 793 million barrels of oil equivalent, approximately 51.6% of which were proved developed reserves and approximately 48.4% of which were proved undeveloped reserves.

PESA s production in Argentina is concentrated in the Neuquén and Austral Basins. PESA holds 579 thousand net acres under production concessions in the Neuquén Basin and 2,632 thousand net acres under production concessions in the Austral Basin. Our gross production acreage in Argentina amounted to 5,828 thousand acres (3,587 thousand net), and we have a total of 2,943 gross productive wells (1,721 thousand net). For the year ended December 31, 2005, combined crude oil and natural gas production in Argentina averaged 105.1 thousand barrels of oil equivalent per day.

In the downstream segment we have refining capacity of 68 thousand barrels per day, distributed in two refineries operating with a throughput rate of 88%. We also have a 28.5% interest in Refinaria Del Norte. We also participate in the retail sector in Argentina, where we currently own 746 retail service stations that operate under the brand names Petrobras (451 stations), Eg3 (248 stations) and San Lorenzo (47 stations).

We also participate, through PESA, in petrochemical businesses, in which we have three plants, Puerto General San Martin, Zarate and Campana in Argentina, where we also have a 40% participation in Petroquímica Cuyo. PESA also owns a petrochemical integrated complex for the production of ethylbenzene, styrene, and polystyrene plant in Brazil, INNOVA, a wholly-owned subsidiary of PESA.

Exchange of assets PETROBRAS and REPSOL YPF

On December 28, 2000, PETROBRAS and Repsol YPF entered into a Contract for the Exchange of Assets, under which PETROBRAS, in exchange of shares of EG3 in Argentina, sold to Repsol YPF a 30% share in Refinaria Alberto Pasqualini, or REFAP, the right to sell fuels in 230 gas stations of BR Distribuidora and a 10% interest in Albacora Leste field.

The contract established that the parties receiving the shares of EG3 and REFAP should, in the course of eight years after January 1, 2001, review every year the reference values of EG3 Group and REFAP S.A., to adjust them so that at the end of the period the definitive value of the shares of EG3 and REFAP (denominated escalators), as well as definitive assets position and payment thereof to the creditor, under common agreement between the parties. Under the Escalators Liquidation Agreement entered into on December 29, 2005, and effective as of January 1, 2006, the companies performed early and definitive liquidation of the escalators.

The final value, including monetary restatement, due by Repsol YPF to PETROBRAS, related to EG3 share, for the full period of 8 (eight) years, including the projections for 2006, 2007 and 2008 amounted to U.S.$335 million. Of this amount U.S.$95 million were applied to reduce property, plant and equipments and U.S.$158 million recorded as extraordinary gain, net of U.S.$82 million of income tax.

The final value, including monetary restatement, due by PETROBRAS to Repsol YPF, related to 30% shareholding in REFAP, for the full period of 8 (eight) years, including the projections for 2006, 2007 and 2008 amounted to U.S.$255 million. This amount was recorded as component of other expenses, net.

Those amounts are definitive, and not subject to review or verification by any of the parties, thus liquidating application and quantification of escalators, as provided for in the Escalators Liquidation Agreement.

Project MEGA

We own a 34% participation in the MEGA project (representing a total investment of U.S.$728 million), a joint venture among us, Repsol-YPF and Dow Chemical to fractionate natural gas liquids. The project consists of a natural gas processing plant in Loma La Lata (Province of Neuquén), a 600 km extension pipeline and a separating plant and port, storage and effluent treatment facilities in Bahía Blanca (Province of Buenos Aires). We are obligated under an off-take contract to take minimum volumes of LPG and natural gasoline, if delivered, at market

prices. We have also recently signed a Reference Value termination Agreement with REPSOL-YPF relating to the valuation of Refineria Alberto Pasqualini (REFAP) shares.

While the MEGA project reached mechanical completion and met or exceeded the performance tests established for the release of the sponsors guarantees, the lenders maintained that other conditions required for the release were not met. The sponsors agreed in December of 2003 to extend their guarantees until December 31, 2005 and to permit all lenders the right to put their MEGA notes to the sponsors immediately prior to the guarantees expiration. In addition, the sponsors granted MEGA s fixed rate noteholders the right to exercise their put immediately. In turn, the sponsors were granted call option rights to redeem MEGA notes. On January 15, 2004, all fixed rate noteholders exercised their put option rights. As a result of these events, we purchased our respective share of MEGA s fixed rate notes (U.S.$58 million). On December 2004, we exercised our call option right (U.S.$54 million) in connection with our share of MEGA s floating rate notes in the same manner as the other shareholders. Also, in December 2004, MEGA pre-payed all the floating rate notes to the noteholders . The remaining, fixed rate notes issued by MEGA are owned by its shareholders. In December 2004, the shareholders entered into a Waiver Agreement to amend the covenants of the Indenture governing the notes to restrict certain financial operations by MEGA. In March and August 2005, MEGA pre-payed all the fixed rate notes, and thus cancelled them.

Other interests of PESA

Regarding the Gas and Energy sector, we participate, through PESA, as indirect shareholder in TGS, which owns a 7,450 km extension pipeline with current firm contracted transport capacity of 71.4 MMcmd and a gas processing plant located in Bahía Blanca, with a processing capacity of 43 million MMcmd.

As far as the electricity assets in Argentina, also through PESA, we cover the entire productive chain. We account for 6.5% of the country s electricity generation through ownership interests in two generation plants, Pichi Picún Leufú (hydrelectric generation) and Genelba (gas-fired power generation). We also have an indirect interest in Transener, Argentina s largest transmission company and owner of 95% of Argentina s high-tension network. PESA has a commitment to divest such interest, as provided under the Resolution issued by *Comisión Nacional de Defensa de la Competencia* (the Argentine antitrust authority), approving the transfer of control of PEPSA to us. PESA also maintains an important presence in the central area of Buenos Aires, an area with more than 2.1 million customers, through Edesur, Argentina s largest energy distribution company by volume.

During 2005, PESA prepaid the total outstanding principal amount of certain Class K and M notes under its Global Notes Program in a total amount of U.S.$335 million. In connection with these series of notes, PESA was subject to compliance with certain covenants, including restrictions on payments of dividends and capital expenditures. As a result of the prepayment, its obligations under these covenants are no longer in effect. PESA also prepaid the outstanding amount of Class C medium term notes for U.S.$63 million.

Bolivian Activities

As of December 31, 2005, our combined crude oil and natural gas proved reserves in Bolivia were approximately 321.1 million barrels of oil equivalent, all of which were proved developed reserves. Approximately 90% of our proved developed reserves in Bolivia are natural gas reserves. We drilled one exploration well in Bolivia in 2005, but we found that it was not commercially feasible. For the year ended December 31, 2005, our combined crude oil and natural gas production in Bolivia averaged 54 thousand barrels of oil equivalent per day.

On May 1, 2006, the new Bolivian government, by decree, nationalized the oil and gas companies operating in Bolivia, subject to a 180-day transition period. This decree established that the state-owned YPFB will become a partner in every asset belonging to the oil and gas sector. We have a 35% interest in the San Alberto and San Antonio Fields (the other partners are Empresa Petrolera Andina (50%) and Total Bolivia (15%)) and in the assets listed below. During this transition period, we expect that we will be involved in complex negotiations with YPFB and the Bolivian government regarding the enforcement of the decree. See Item 3. Key Information Risk Factors Risks Relating to Our Operations¾ The recent nationalization measures taken by the Bolivian and Venezuelan governments may have an adverse effect on our results of operations and financial condition.

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The following assets will also be subject to the abovementioned decree:

(i) Our 44.5% of the shares of Transierra S.A, the owner and operator of the Yacuiba-Rio Grande gas pipeline (GASYRG), a pipeline in Bolivia that connects the gas fields in the south of Bolivia to the Bolivia-Brazil pipeline. Presently the pipeline has a capacity of 17 MMcmd, and installation of another compression unit will increase the capacity to 23 MMcmd. Investment for this project totaled more than U.S.$375 million. We also provided all the capital for the San Marcos pipeline, which presently transports less than 0.1 MMcmd of natural gas to the city of Puerto Suárez (Bolivia), on the Brazilian border.

(ii) Our 21% interest in a natural gas compression plant in Rio Grande, Bolivia, which has a capacity to compress up to 34.0 MM cmd.

(iii) Our 51% interest in Petrobras Bolivia Refinación PBR, ex-Empresa Boliviana de Refino (EBR), with Petrobras Energia S.A. PESA as the other partner, with 49% of the equity. PBR owns two Bolivian refineries located in Cochabamba and Santa Cruz de la Sierra, with production capacity of 60 thousand barrels of crude oil per day, operating with a throughput rate of 67%. PBR wholly owns Petrobras Bolivia Distribución PBD, ex-Empresa Boliviana de Distribución, or EBD, a company with a network of 104 service stations.

Venezuelan Activities

As of December 31, 2005, PESA s rights in Venezuela for exploration and production were held under operating service contracts. In April 2006, PESA, Petróleos de Venezuela S.A. (PDVSA) and Corporación Venezolana del Petróleo SA (CVP) entered into a Memorandum of Understanding in order to effect migration of the operating agreements to partially state-owned companies, which will have the effect of nationalizing the oil and gas reserves in Venezuela. The economic effects of the migration came into force starting April 1, 2006. See Item 3. Key Information Risk Factors Risks Relating to Our Operations¾ The recent nationalization measures taken by the Bolivian and Venezuelan governments may have an adverse effect on our results of operations and financial condition for a description of the risks associated with these measures.

As of December 31, 2005, estimated proved oil and gas reserves attributable to PESA s operations in Venezuela amount to 269 million barrels of oil equivalent, accounting for 35.4% of PESA s total reserves. Estimated proved oil and gas reserves attributable to the company s operations in Venezuela are calculated on the basis of the contractual structure in force as of such date.

Operating Services Agreement

In 1994, during what is referred to as the second round bids, PESA was awarded the first service contract by PDVSA at the Oritupano-Leona field to provide production services for a 20-year period. (We refer to the contracts awarded pursuant to the second round bids as the second round operating agreements.) Oritupano-Leona is an approximately 215,000 net acre block located in the Oriental basin that includes 272 producing wells.

The Oritupano Leona joint venture s sole customer for the sale of oil production was PDVSA. Per our operating service agreement, PDVSA was the sole owner of the facilities, assets and/or operating equipment used by the joint venture to conduct the activities provided for in this agreement. For the provision of production services, we received (1) a variable fee based on production volumes plus (2) an additional fee for reimbursement of capital expenditures. The contract had a cap on the amount, which we can collect, which was reset quarterly based on the market price of oil. As of December 2005, this cap was approximately U.S.$37.9 per barrel. The contract also established an incentive, which was not subject to the cap, for any production over 155 million barrels of oil, calculated using a rate per barrel that is based on variations of certain crude oil prices. During the first quarter of 2005, cumulative field production exceeded the 155 million barrel production level and, since then, any additional production had been subject to the incentive. This additional compensation was subsequently limited by the application of the 66.67% limit on sales price imposed by the Venezuelan government under the provisional agreements relating to migration to the partially state-owned companies.

In 1997, during what is referred to as the third round bids, PDVSA awarded PESA three 20-year service contracts for the exploration and production of Acema, La Concepción and Mata blocks. (We refer to the contracts awarded pursuant to the third round bids as the third round operating agreements and the three blocks awarded to us during those bids, namely the Acema, La Concepción and Mata blocks, as the third-round blocks.) The bids were initially made through joint ventures. PESA had a 90% interest in the La Concepción block and an 86.2% interest in the Acema and Mata oil blocks. La Concepción is an approximately 55,000 net acre block located in the Maracaibo basin with 116 producing wells. Acema and Mata, located in the Oriental basin, are approximately 64,000 and 45,000 net acre blocks with 18 and 57 producing wells, respectively. According to the concession contracts, PDVSA was the sole owner of the facilities, assets, and operating equipment. PESA received a fee for each barrel delivered which has a fixed component related to contractual baseline production and a variable component related to the incremental production that covered investments and production costs, plus a gross profit up to a maximum that is tied to a basket of international oil prices.

Nationalization measures by the Venezuelan government

In April 2005, the Venezuelan Energy and Oil Ministry instructed PDVSA to review the thirty-two operating agreements signed by PDVSA with oil companies from 1992 through 1997, including agreements with our affiliates in connection with the areas of Oritupano Leona, La Concepción, Acema and Mata. According to the Venezuelan Energy and Oil Ministry, each of these operating agreements includes clauses that do not comply with the Venezuelan Hydrocarbon Law enacted in 2001.

The Venezuelan government has instructed PDVSA to take measures in order to convert all effective operating agreements into state-controlled contracts in order to grant the Venezuelan government, through PDVSA, more than 50% ownership of each field. Regarding such agreements, the government instructed PDVSA that the total amount of accumulated payments to contractors during the calendar year 2005 would not exceed 66.67% of the value of oil and gas produced under the related agreement.

During 2005, PDVSA took several actions in connection with the operating agreements as a way to promote the nationalization, including, among others:

(a) PDVSA approved a reduced amount of development investments for the Oritupano Leona area;

(b) Difficulties for the reception by PDVSA of the oil produced were verified;

(c) Partial payment in bolivares of the billings. In this regard, in June 2005, PDVSA notified Petrobras Energía Venezuela, S.A. that it would thereafter pay in bolivares the portion of the compensation provided in the operation contracts currently in effect related to the domestic component of the materials and services provided. Such decision conflicts with the provisions of the operation contracts mentioned above, under which PDVSA is required to make such payments in U.S. dollars. During the transition phase, and until PDVSA performed an audit to determine the portion attributable to the domestic component, PDVSA decided that it would pay 50% of the amounts set forth in such contracts in U.S. dollars and the remaining 50% in bolivares. Subsequently and based on the collections related to 2005 third quarter production, the portion of the payment in bolivars was reduced to 25%;

(d) The SENIAT (National Integrated Tax Administration Service) performed several tax inspections on the companies that operate the 32 oil operating contracts, and as a result of these inspections, challenged prior tax filings. In this regard, as of December 31, 2005, we recorded a U.S.$ 18 million loss; and

(e) an increase in income tax rate from 34% to 50%.

On September 29, 2005, Petrobras Energía Venezuela S.A. signed provisional agreements with PDVSA, whereby it agreed to negotiate the terms and conditions related to the conversion of the agreements in the areas of Oritupano Leona, La Concepción, Acema and Mata, and also acknowledged the application of the 66.67% cap over the value paid to contractors. The provisional agreement for the Oritupano Leona area was signed subject to the approval of PESA s General Shareholders Meeting and of the shareholders of PEPSA, which were favorable to the agreements.

In April 2006, PESA entered into Memorandums of Understanding (MOUs) in order to effect migration of the operating agreements of the Oritupano Leona, La Concepción, Acema and Mata areas to partially state-owned companies. Pursuant to the abovementioned MOUs, interest of private investors in the partially state-owned companies will be limited to 40%, with the Venezuelan Government holding a 60% interest. PESA s indirect interest in the Oritupano Leona, La Concepción, Acema and Mata areas will be 22%, 36%, 34.5% and 34.5%, respectively. Before these MOUs, PESA s indirect interest in the Oritupano Leona, La Concepción, Acema and Mata areas were 55%, 90%, 86.2% and 86.2%, respectively. The economic effects of the migration became effective on April 1, 2006.

The MOUs establish that CVP will recognize a divisible and transferable credit in favor of the private companies that will compose the partially state-owned companies. PESA was awarded a credit in the amount of U.S.$ 88.5 million. This credit will not bear interest and may only be used for future investments in oil and gas exploration, development or production activities in Venezuela.

Execution of the MOUs is subject to approval of the relevant authorities, including the National Assembly, as specified below, and PESA s Board of Directors.

The organization of the partially state-owned companies and the terms and conditions governing the performance of primary activities thereby are also subject to approval of the Venezuelan Ministry of Energy and Oil and the Venezuelan National Assembly.

As of December 31, 2005, we recorded an impairment charge of U.S.$134 million in order to adjust the book value of our Venezuelan assets to their recoverable value.

Ecuadorian Activities

In Ecuador, PESA operates Blocks 18 and 31. As of December 31, 2005, PESA held a 70% and 100% interest in Block 18 and 31, respectively.

Block 18 is located in the Oriente basin of Ecuador, having a significant potential of 28º to 33° API light crude oil reserves. The concession for production activities in Block 18 is for an initial 20-year term from October 2002. Once this term expires, Ecuadorian hydrocarbon laws provides for the possibility of an additional five-year extension period.

Block 18 production accounted for 5% of PESA s total average production in barrels of oil equivalent in 2005. It has eight productive wells, two are located at the Pata field and six are located at the Palo Azul field. In addition, the area has early production facilities that can handle a daily gross production of 20,000 barrels per day. In 2005, PESA drilled 11 development wells and 3 workovers were completed with very good results; the 12-inch, 15.6 km-long export pipeline was built; and the expansion of the temporary processing plant was completed. Development of Block 18 will continue through drilling and construction of facilities to increase treatment capacity.

Block 31 is located in a highly sensitive ecological area of the Amazon jungle in the central part of the eastern border of the upper Amazon basin and covers an area of 494 thousand net acres. Pursuant to the block s production sharing agreement between Petroecuador and PESA, Petroecuador is entitled to a crude oil production share ranging between 15% and 17%, depending on the field s daily crude oil production and crude oil gravity.

PESA has conducted extensive exploratory work in Block 31, including the drilling of four exploratory wells, which led to the discovery of the Apaika/Nenke, Obe, and Minta fields. Significant investments are required to the development, but changes in PESA s investment strategy following the Argentine crisis have resulted in a redefinition of the amounts and timing of the original investment plan.

In August 2004, the Minister of Energy of Ecuador approved an environmental impact study, completing all of the required steps for the approval of the development plan with a 20-year exploitation period. In the initial three-year period, the plan contemplates investments of U.S.$75 million, and an obligation to provide Petroecuador with a guaranty of 20% of this amount. In December 2005, as part of these contemplated investments, PESA built a pier on the southern border of the Napo River and a 12.7 km access road. Due to limitations imposed by the Ministry

of the Environment in Ecuador (MAE) relating to works within Parque Nacional Yasuní, works were temporarily suspended. Petrobras Energía Ecuador, MAE and the Ministry of Energy and Mines of Ecuador are working to agree on a new development plan for Block 31. Based on the proposal submitted by the Company, the new development project associated with the Apaika and Nenke fields will minimize impact on Parque Nacional Yasuní. PESA will use cutting-edge technology in connection with oil production and environmental protection, this certainly being an example of integration between oil production activities and nature.

As regards exploitation of Blocks 18 and 31, the Company signed an agreement with OCP (Oleoducto de Crudos Pesados), whereby an oil transportation capacity of 80,000 bbl/d is secured for a 15-year term, starting November 10, 2003. Under the Ship or Pay transportation agreement, the Company must fulfill its Ship or Pay contractual obligations for the aggregate oil volume committed, even though no crude oil is transported, and pay, together with other participants, a fee covering OCP operating costs and financial services. As of December 31, 2005, such fee amounted to U.S.$2.26 per barrel.

Additionally, Petrobras Energía S.A., or PESA, has a 15-year ship or pay agreement for 80,000 barrels per day through the OCP pipeline in Ecuador. Estimated payments respective to the commitment are approximately U.S.$300 million for the next five year term, and U.S.$820 million total contract value. In January 2005, PESA entered into a provisional sale agreement with Teikoku Oil Co., based in Japan, subject to final approval by the Ministry of Energy of Ecuador. Upon approval, PESA will transfer 40% of its rights and interest in Blocks 18 and 31 and the corresponding rights and obligations, including in the OCP, to Teikoku Oil Co. See International Ecuadorian Activities.

In January 2005, PESA entered into an agreement with Teikoku whereby, after obtaining approval by the Ministry of Energy of Ecuador, we will transfer 40% of our rights and interest in Blocks 18 and 31. In addition, once production in Block 31 reaches an average of 10,000 barrels of oil per day for a period of 30 consecutive days, Teikoku has agreed to assume 40% of the rights and obligations resulting from the crude oil transportation agreement entered into with OCP.

As of December 31, 2005, PESA s crude oil proved reserves in Ecuador were approximately 51.3 million of barrels of oil and its oil production averaged 9.1 thousand barrels per day.

Peruvian Activities

Through PESA, we have the rights to oil and gas production in Lote X, a 116 thousand acre block in Peru s Talara Basin. PESA has entered into a long-term sales contract under which Perupetro (the Peruvian state-owned company) is obligated to purchase all of the production from Lote X at market prices. The sales contract will expire in July 2006. As of December 31, 2005, PESA s combined crude oil and natural gas proved reserves in Peru were approximately 109 million of barrels of oil equivalent and its combined oil and gas production averaged 14.4 thousand barrels per day.

In May 2004, PESA entered into a contract with Repsol Exploración Perú S.A. to perform certain exploration activities jointly in Block 57, which is located in the Ucayali basin. Pursuant to this contract, PESA participate in Block 57 with a 35.15% interest. The assignment is subject to approval by the governmental authorities and the Company is negotiating the joint operation agreement with Occidental and the other partner, Repsol.

As of November 2004, PESA entered into an agreement with Occidental for the assignment to Petrobras Energía de Perú S.A. of 30% of the rights in the License Agreement for Hydrocarbon Exploration and Production in Lote 103. The assignment is subject to approval by the governmental authorities and the Company is negotiating the joint operation agreement with Occidental and the other partner, Repsol.

In 2005, PESA entered into license agreements for hydrocarbon exploration and production in Lote 58 and Lote 110 at the Ucayali Basin (adjacent to Camisea) and in Lote 112 at the Marañón Basin. Perupetro has recently awarded Petrobras Energía del Perú S.A Lote 117 located at the Marañón Basin.

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Uruguayan Activities

In December 2004, we entered the Uruguayan market through the acquisition of 55% of the voting shares of Conecta S/A, which is one of the two local natural gas distribution companies operating in Uruguay, for U.S.$3.2 million. The other 45% of the Conecta s voting shares remains with the state-owned Administratión Nacional de Combustibles Alcohol y Portland ANCAP.

Conecta operates approximately 317 km of gas pipelines, and has exclusivity to supply small to medium size consumers with demand of up to 5,000 cmpd. Conecta presently has 4400 clients, mostly with residential buildings, selling approximately 39,300 cmpd. We estimate that this represents about 20% of the total Uruguayan demand for natural gas, which is located near the gas pipelines in the cities of Paysandu and Ciudad de la Costa. Conecta s revenues in 2005 were U.S.$ 3.1 million.

In November of 2005, in line with our Strategic Plan, our board of directors approved the acquisition of 51% of the capital of Gaseba Uruguay Grupo Gaz de France S.A. (Gaseba Uruguay S.A.), a natural gas distribution concession in Montevideo, Uruguay. This concession runs for a term of 30 years and aims to enhance our natural gas business in Uruguay.

At the end of 2005, we signed a Share Purchase Agreement for the acquisition of Shell s fuel and lubricant retail and commercial businesses in Uruguay. We now control 89 services stations, and installations for aviation fuel and asphalt, salling and a marine fuels business.

Paraguayan Activities

At the end of 2005, Petrobras signed a Share Purchase Agreement for acquisition of Shell s fuel and lubricant retail and commercial businesses in Paraguay. The Company now controls 134 services stations, with 52 convenience stores installations for aviation fuel supply and one LPG refueling plant.

Colombian Activities

During 2005, we signed a farm-in contract in Colombia with Hocol, which allowed us to acquire interests in the Upar, San Jacinto, Rio Paez, Achira and Rio Cabrera Blocks.

We have interests in eighteen exploration contracts and six production contracts in Colombia. We are the operating company in twelve of these contracts.

As of December 31, 2005, our combined crude oil and natural gas proved reserves in Colombia were approximately 32 million of barrels of oil equivalent and our combined oil and gas production averaged 16.6 thousand barrels per day.

At the end of 2005, we signed a Share Purchase Agreement for acquisition of Shell s fuel, retail and commercial businesses, in Colombia, Paraguay and Uruguay for approximately US$140 million. We now control 139 services stations, with 17 convenience stores and installations for commercialization of aviation fuel and asphalt.

We carried out seismic studies in Block Tayrona, a 45,000km^2 offshore block in the Caribbean Sea of Colombia, in association with Exxon and Ecopetrol. We are the operator of the concession during the exploration phase.

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African Activities

We have interests in four blocks in Nigeria, OPL-216, OPL-246, OPL-324 and OPL-315. We are partners in Agbami Field, on OPL-216, operated by Chevron, presently on development phase, where first oil will occur in mid 2008, from a FPSO with a production capacity of 250,000 bopd. In 2005, we have drilled 6 development wells in Agbami field. We have participation also in Akpo field, on OPL-246, operated by Total, with production scheduled to commence in the end of 2008, also by the means of a FPSO (175,000 bopd), now under construction. Two other discoveries are under appraisal on Block OPL-246: Egina and Preowey fields, where we drilled one successful extension well each, in 2005. Agbami and Akpo are both considered as World Class oil fields and our share in their production shall correspond to an aggregate of 67,000 bopd at their peak.

We withdrew from the exploration block OPL-250 and we are the operating company in two other exploration blocks, OPL-324 and OPL-315 where drilling activity will occur in 2006 and 2007. Participation in Block OPL-315 was acquired in the last Nigerian Bid Round, held in August 2005.

On March 12, 2005, we signed an exploration and joint production agreement with Libya s state-owned National Oil Corporation (NOC). This agreement provides for the exploration of four blocks in Area 18, which have an extension of 10,307 square kilometers and are located in the Mediterranean Sea at water depths of 200 to 700 meters. We own a 70% interest in a consortium with Oil Search Limited (OSL) and will be the operating company in the area. Under the agreement, the exploration phase will last five years and may be extended for 25 more years if discoveries are made. At least U.S.$21 million will be invested in the exploration phase and we will be required to drill a well and conduct seismic evaluations.

The Angolan branch of our wholly-owned subsidiary, Petrobras International Braspetro B.V., has continued to perform as a non-operating partner in two licenses under petroleum sharing agreements. No exploratory drilling was carried out in Angola during 2005. As of December 31, 2005, our combined crude oil and natural gas proved reserves in Angola were approximately 8.59 million of barrels of oil equivalent and our oil production averaged 6.73 thousand barrels per day in this month. For the year 2005, oil production averaged 8.3 thousand barrels per day.

We recently participated in three bidding rounds promoted by Angolan government in 2006 and acquired interests in 4 exploration blocks offshore Angola: deep water Blocks 15/06, 18/06 and 26, being the operator in the latter two, and shallow water Block 6, also holding the operatorship. Drilling activity in such blocks shall begin not earlier than 2008. Block 18/06 is the remaining area of Block 18, operated by BP. Likewise Block 18/06 which is the remaining area of Block 15/06, operated by Exxon.

In 2004, we signed a joint production agreement with the Tanzanian government and the state-owned oil company, Tanzania Petroleum Development Corporation (TPDC). This agreement provides for the exploration of Block 5, which has an extension of 9,250 square kilometers and is located in the Mafia Basin at water depths of 300 to 3000 meters. The agreement will be in force for up to 11 years. In 2005, we conducted geological studies on Block 5. Petrobras was awarded a new exploration asset in 2005, the Block 6, with an extension of 9,250 square kilometers, adjacent to Block 5, whose production sharing agreement are under negotiations at the time of this writing.

Middle East Activities

We have signed a contract with Iran s state-owned company, National Iranian Oil Company (NIOC), for the exploration of Block Tusan in shallow waters of the Persian Gulf. We own a 100% interest in this block. The exploration will be carried out by our Iranian subsidiary Petrobras Middle East B.V., which was organized in October 2004. During 2005, we evaluated other exploration opportunities in the Middle East.

Turkey Activities

We were the winner of two of the three blocks offered in the bidding process for deepwater exploration and production in the Black Sea held by the Turkish Türkýye Petrollerý Anoným Ortaklidi (TPAO) National Oil Company.

We and TPAO will soon begin negotiating all the pertinent contractual documentation, ensuring us 50% participation in the exploration and production of Blocks 3920 (Kirklarelli) and 3922 (Sinop).

According to our completed technical evaluation, the two blocks that we purchased are the ones that present the best geological possibilities. The Kirklarelli Block, located in the western part of the Turkish sector of the Black Sea, has an average depth of 1,200 meters, and the Sinop Block is on the eastern side of the Black Sea, and has an average depth of 2,200 meters.

Gulf of Mexico Activities

Petrobras America, Inc., or PAI, our wholly-owned subsidiary, continues to expand its activities in the Gulf of Mexico s deep and ultra-deep waters through farm-in agreements (by which PAI, rather than obtaining an interest directly from the relevant government authorities, acquires an interest from a party who has already obtained such interest), and participation in leases and sales conducted by the United States Minerals Management Service (the U.S. industry regulator). As of December 31, 2005, PAI held interests in 271 offshore blocks in the Gulf of Mexico from shallow to ultra-deep waters, 180 of which were operated by our subsidiary. On March 21, 2006, we announced that we tendered the highest bids for 10 out of 17 blocks in the central U.S. sector of the Gulf of Mexico at an auction organized by the MMS.

As a result of its participation in Gulf of Mexico Lease Sale 196, Petrobras was awarded a total of 53 exploration blocks: 18 blocks strengthened its position in ultra-deep oil prospects while 26 blocks granted a strong coverage on the westernmost part of the Gulf, where we now hold full control over 10 prospects with good potential for gas. The first drilling will begin later in 2006.

The average production in the Gulf of Mexico reached only 4,600 bopd, approximately 60% of the target, mainly due to the effects of Hurricanes Rita and Katrina.

In September 2005, PAI announced that its first Gulf of Mexico well confirmed the extension of the Cottonwood Discovery, located in the Garden Banks 244 Block. Having now confirmed the extension of the gas field, the company has begun a fast-track development of the gas reservoirs, aiming at starting production by early 2007. Petrobras has an 80% participating interest and is the operator of the block. The area of Garden Banks is one of the four core areas selected by Petrobras as a priority for exploration in the U.S. waters of the Gulf of Mexico, which also include the ultra deepwater, the very deep reservoirs of the shallow water shelf and the westernmost area of Gulf of Mexico. According to the Business Plan we recently announced, the total investments allocated to the Gulf of Mexico in the period 2006-2010 will reach $1.5 billion.

In November 2005, we signed a Memorandum of Understanding with Astra Oil Company (Astra), combining forces to establish a joint venture trading and refining company in the United States. On February 3, 2006, the PETROBRAS Board of Directors approved a purchase and sale agreement with Astra Oil Trading NV for the acquisition of 50% interest of the refinery Pasadena Refining System Inc. (PRSI), formerly Crown Refinery in Pasadena, Texas, for approximately U.S.$370 million.The initial business plan calls for joint venture operation with respect to the trading and commercial management of the Pasadena Refining System (PRSI), formerly the Crown Refinery in Pasadena Texas. The PRSI refinery is currently being upgraded to meet new Environment Protection Agency (EPA) Clean Air Standards for gasoline and diesel, and as soon as reasonably practical, the refinery will also be modified to handle a wide range of heavy crude and feedstock, including our production from the Marlim field.

Mexican Activities

In 2003, as part of the bidding launched by Petróleos Mexicanos (PEMEX) for the operation of areas under multiple service contracts, contracts for the Cuervito and Fronterizo blocks were awarded to a joint venture composed of us (45% interest), the Japanese company Teikoku (40%) and the Mexican company Diavaz (15%). There are 12 gas discoveries in this block, which shall be developed with a total expenditure of U.S.$510 million.

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PIFCo

PIFCo was established on September 24, 1997 as a wholly-owned subsidiary of Braspetro Oil Services Company, or Brasoil, a wholly-owned subsidiary of Petrobras Internacional S.A. (Braspetro), which has since been absorbed by us. PIFCo was initially incorporated under the name Brasoil Finance Company, which was changed by special resolution of PIFCo s shareholders to Petrobras International Finance Company on September 25, 1997. On January 14, 2000, the board of directors of Braspetro and Petrobras approved the transfer of 100% of PIFCo s voting shares from Brasoil to us. Since April 1, 2000, PIFCo has been our wholly-owned subsidiary. On October 21, 2005, we replaced the existing Memorandum and Articles of Association in its entirety, with a new amended and restated Memorandum and Articles of Association.

PIFCo is a tax exempt company incorporated with limited liability under the laws of the Cayman Islands. PIFCo s registered office is located at Harbour Place, 103 South Church Street, 4th floor, George Town, Grand Cayman, Cayman Islands, and PIFCo s telephone number is 55-21-3224-1410.

PIFCo Business Overview

PIFCo was incorporated in order to facilitate and finance the import of crude oil and oil products by us into Brazil. Accordingly, PIFCo s primary function is to act as an intermediary between third-party oil suppliers and us by engaging in crude oil and oil product purchases from international suppliers and reselling crude oil and oil products in U.S. dollars to us on a deferred payment basis, at a price which includes a premium to compensate PIFCo for its financing costs. PIFCo is generally able to obtain credit to finance purchases on the same terms granted to us, and PIFCo buys crude oil and oil products at the same price that suppliers would charge us directly.

As part of our strategy to expand our international operations and facilitate our access to international capital markets, PIFCo engages in borrowings in international capital markets supported by us, primarily through standby purchase agreements of the related securities.

In addition, PIFCo also engages in a number of activities that are conducted by three wholly-owned subsidiaries:

- Petrobras Europe Limited, or PEL, a United Kingdom company that acts as an agent and advisor in connection with our trading activities in Europe, the Middle East, the Far East and North Africa;

- Petrobras Finance Limited, or PFL, a Cayman Islands company, that carries out a financing program supported by future sales of bunker fuel and fuel oil; and

- Bear Insurance Company Limited, or BEAR, a company incorporated in Bermuda that contracts insurance for us and our subsidiaries.

As part of our restructuring of our international business segment, in January 2003, PIFCo transferred to us Petrobras Netherlands B.V., or PNBV, a Dutch company engaged in leasing activities of primarily offshore equipment to be used by us for exploration and production of crude oil and natural gas. PNBV became our wholly-owned subsidiary, effective as of January 2003.

Beginning in 2004, as part of our restructuring of our offshore subsidiaries in order to centralize trading operations, PIFCo has engaged in limited exports of oil and oil products and has begun to store oil and oil products in Asia.

In April 2006, PIFCo incorporated a new wholly-owned subsidiary: Petrobras Singapore Private Limited, or PSPL, a company incorporated in Singapore to trade crude oil and oil products in connection with our trading activities in Asia. This company has not yet initiated operations.

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PIFCo s Principal Commercial Activities

PIFCo s principal activity is the purchase of crude oil and oil products for resale to us and, to a limited extent, third parties. PIFCo acquires substantially all of its crude oil and oil products either through purchases on the spot market or short-term supply contracts. PIFCo acquires a small portion of its crude oil and oil products through long-term supply contracts. PIFCo s crude oil and oil product purchase obligations are, in most instances, guaranteed by us. PIFCo sells the products to us at the purchase price it paid, plus a premium, determined in accordance with a formula designed to pass on PIFCo s average costs of capital to us.

In addition, PIFCo finances its oil trading activities principally from commercial banks, including lines of credit and commercial paper programs, as well as through inter-company loans from us and the issuance of notes in the international capital markets.

The following chart illustrates how PIFCo acts as the intermediary between international crude oil suppliers and us.

PIFCo purchases crude oil and oil products from international oil suppliers on a free-on-board (F.O.B.) basis under standard terms that traditionally require payment within 30 days from the bill of lading. We buy crude oil and oil products from PIFCo under terms that allow for payment up to 330 days from the date of the bill of lading. Since February 2005, we began to buy crude oil and oil products from PIFCo under terms that allow for payment up to 330 days from the date of the bill of lading. Before February 2005, we bought crude oil and oil products from PIFCo under terms that allowed for payment up to 270 days from the date of the bill of lading. We would typically be unable to meet the 30-day payment term imposed by international suppliers because of the complexity of Brazilian customs and importing regulations. For example, if a shipment to which a bill of lading relates must be delivered to different parts of Brazil, different sets of documents must be delivered to each delivery point. Depending on the unloading ports locations, this process may be completed up to 120 days from the vessel s departure. Because PIFCo is not subject to the Brazilian regulations applicable to us, PIFCo can pay the international supplier on time without having to produce these different sets of documents. To cover its financing costs, PIFCo includes a premium when it sells crude oil and oil products to us.

PIFCo s subsidiaries are:

Petrobras Europe Limited (PEL)

In May 2001, PIFCo established PEL, a wholly-owned subsidiary incorporated and based in the United Kingdom, to consolidate our trade activities in Europe, the Middle East, the Far East and North Africa. These activities consist of advising on, and negotiating the terms and conditions for, crude oil and oil products supplied to PIFCo and us, as well as marketing Brazilian crude oil and crude oil products exported to the geographic areas in which PEL operates. PEL plays an advisory role in connection with these activities and undertakes no direct or additional commercial or financial risk. PEL provides these advisory and marketing services as an independent

contractor, pursuant to a services agreement between PEL and us. In exchange, we compensate PEL for all costs incurred in connection with these activities, plus a margin.

Petrobras Finance Limited (PFL)

In December 2001, PIFCo established PFL, a wholly-owned subsidiary incorporated and registered in the Cayman Islands. PFL primarily purchases fuel oil from us and sells the products in the international market in order to generate export receivables to cover its obligations to transfer these receivables to a trust under an exports prepayment program. Until June 1, 2006, PFL also purchased bunker fuel from us. The exports prepayment program helps provide PFL with the funding necessary to purchase oil products from us, as described below.

Bear Insurance Company Limited (BEAR)

In January 2003, PIFCo received BEAR from Brasoil. This transaction took place as part of the restructuring of our international business segment. BEAR currently serves as an intermediary for us, advising on, and negotiating the terms and conditions of, certain of our insurance policies.

Petrobras Singapore Private Limited (PSPL)

In April 2006, PIFCo incorporated a new wholly-owned subsidiary: Petrobras Singapore Private Limited, or PSPL, a company incorporated in Singapore to trade crude oil and oil products in connection with our trading activities in Asia. This company has not yet initiated operations.

Exports Prepayment Program

We sell and deliver fuel oil and, subject to certain conditions, other oil products (collectively, the Eligible Products) to PFL under two principal agreements: Master Export Contract and the Prepayment Agreement. Until June 1, 2006, bunker fuel was also an Eligible Product under the Agreement. The PF Export Receivables Master Trust, or the Trust, was formed under the laws of the Cayman Islands to provide PFL with the funding necessary to purchase Eligible Products from Petrobras and resell these products through the arrangements described below.

On December 21, 2001, the Trust issued to PFL U.S.$750 million of Senior Trust Certificates (collectively, the Series 2001 Senior Trust Certificates) and U.S.$150 million of Junior Trust Certificates (the Series 2001 Junior Trust Certificates, that together are called the Series 2001 Trust Certificates). PFL in turn offered the Series 2001 Senior Trust Certificates in four series (series A-1, A-2, B and C) to certain certificate holders.

On May 21, 2003, the Trust issued to PFL U.S.$550 million of Senior Trust Certificates (the Series 2003-A Senior Trust Certificates), maturing on June 1, 2015. On the same date, the Trust issued U.S.$200 million of Senior Trust Certificates (the Series 2003-B Senior Trust Certificates), maturing on June 1, 2013. The Series 2003-A Senior Trust Certificates, along with the Series 2003-B Senior Trust Certificates and the Series 2001 Senior Trust Certificates, represent senior undivided beneficial interests in the property of the Trust (other than certain charitable property held by the Trust).

On the same date, the Trust also issued to PFL U.S.$110 million in Series 2003-A Junior Trust Certificates and U.S.$40 million in Series 2003-B Junior Trust Certificates (collectively, the Series 2003 Junior Trust Certificates. The Series 2003 Junior Trust Certificates represent, together with the 2001 Junior Trust Certificates, junior subordinated undivided beneficial interests in the property of the Trust (other than the charitable property).

The series 2003-A Senior Trust Certificates, the 2003-B Senior Trust Certificates and the 2003-A Junior Trust Certificates, the 2003-B Junior Trust Certificates are referred to collectively as series 2003 Trust Certificates.

PFL agreed to transfer to the Trustee, in return for the Series 2001 Senior Trust Certificates and Series 2001 Junior Trust Certificates, the right to a specified amount of receivables to be generated from PFL s sale of Eligible Products with a value equal to the aggregate amount scheduled to be paid in respect of the Series 2001 Senior Trust Certificates and the Series 2001 Junior Trust Certificates. PFL also agreed to transfer the Trustee, in return for the

Series 2003 Senior Trust Certificates and Series 2003 Junior Trust Certificates, the right to an additional specified amount of receivables to be generated from PFL s sale of Eligible Products with a value equal to the aggregate amount scheduled to be paid in respect of the Series 2003 Senior Trust Certificates and the Series 2003 Junior Trust Certificates.

The value of receivables scheduled to be designated for sale in any quarterly period represents a portion, but not all, of the receivables expected to be generated from the sale of Eligible Products by PFL in such period. The remainder of such receivables remain the property of PFL.

The timely payment of interest on, and scheduled principal of, each series of the Series 2001 Senior Trust Certificates is unconditionally and irrevocably guaranteed under financial guaranty insurance policies issued by XL Capital Assurance Inc., MBIA Insurance Corporation or Ambac Assurance Corporation (collectively, the Enhancers). The timely payment of interest on, and scheduled principal of, the Series 2003-B Senior Trust Certificates is unconditionally and irrevocably guaranteed under a financial guaranty insurance policy issued by MBIA Insurance Corporation. The Series 2003-A Senior Trust Certificates do not have the benefit of any financial guaranty insurance policy.

In addition to the Series 2001 Trust Certificates and the Series 2003 Senior Trust Certificates currently outstanding, additional series of senior trust certificates (which may or may not benefit from a financial guaranty insurance policy) may be issued to PFL from time to time if Petrobras agrees to sell additional Eligible Products to PFL in an amount that is adequate to make all required payments under the additional series of senior trust certificates and certain other conditions are met.

In May 2004, PFL and the PF Export Trust executed an amendment to the Trust Agreement allowing the Junior Trust Certificates, which amounted to U.S.$300 million as of December 31, 2004, to be set-off against the related Notes, rather than paid in full, after fulfillment of all obligations pursuant to the Senior Trust Certificates. This amendment to the Trust Agreement had the effect of allowing amounts related to the Junior Trust Certificate to be reported net in the financial statements.

On September 1, 2005, PFL prepaid the floating rate Senior Trust Certificates (Series 2001-A2 and 2001-C) in accordance with the applicable provisions of the governing agreements. In order to facilitate this advance payment, Petrobras prepaid to PFL the amount of U.S.$330.3 million related to the export prepayment program.

On March 1, 2006, PFL prepaid the fixed rate Senior Trust Certificates (Series 2001-A1 and 2001-B) in accordance with the applicable provisions of the governing agreements. In order to facilitate this advance payment, Petrobras prepaid to PFL an amount of U.S.$333.9 million related to the export prepayment program. As a result of this prepayment, U.S.$150 million of Junior Trust Certificates were cancelled by offsetting the Certificates with the obligation to deliver future receivables.

On May 23, 2006, PFL has successfully completed a solicitation of consents from holders of the Series 2003-A 6.436% Senior Trust Certificates due 2015 issued by PF Export Receivables Master Trust. The amendments sought to eliminate exports of bunker fuel from the transaction so that the securities will be collateralized only by receivables from sales of fuel oil exported by PETROBRAS and to reduce the minimum average daily gross exports of fuel oil for any rolling twelve-month period. PFL also obtained the consent from the holders of Series 2003-B 3,748% due 2013. The amendments became effective on June 1, 2006.

Petrobras Bunker Fuel and Fuel Oil Business

As described above, PFL, a wholly-owned subsidiary of PIFCo, purchases fuel oil from Petrobras and sells the products in the international market in order to generate export receivables to cover its obligations under the exports prepayment program. Until June 1, 2006, PFL also purchased bunker fuel from us but since then we have been selling bunker fuel in the international market directly and this product is no longer subject to our exports prepayment program.

Bunker fuel is a common term for marine fuels that are burned in the boilers or engines of ships. Petrobras produces and exports two types of bunker fuel: intermediate fuel oil or marine fuel (for ships main engines and, occasionally, auxiliary engines) and marine diesel fuel or marine gas oil (for auxiliary engines and main engines of military vessels).

Petrobras bunker fuel production in 2005 was 28,000 Mbbl, as compared to 27,425 Mbbl in 2004 and 26,741 Mbbl in 2003. Petrobras total bunker fuel production totaled 139,503 Mbbl for the period from January 1, 2001 to December 31, 2005. Petrobras exports approximately 82% of the bunker fuel it produces, with the exception of bunker fuel used by Petrobras fleet. Bunker fuel sold in Brazil by Petrobras to ships owned by non-Brazilian companies is considered an export under Brazilian regulations.

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PETROBRAS ANNUAL BUNKER FUEL PRODUCTION

	2005	2004	2003	2002	2001
			(Mbbl)		
Export	22,948	22,452	21,402	23,653	21,438
Domestic Consumption	1,313	1,061	1,048	1,620	1,533
Petrobras Fleet	3,739	3,912	4,291	4,596	4,497
Total	28,000	27,425	26,741	29,869	27,468

Fuel oil originates from residual fractions of distillation units at the refinery and from other processes such as deasphalting. Diluents in the form of lighter cutter stocks are mixed into the residue pool to create the desired viscosity for different types of fuel oil.

Major buyers of Petrobras fuel oil include utilities, refineries and traders. Fuel oil is used by industries and utilities to run machinery and generate electricity. Commercial buildings and homes employ fuel oil for heating purposes, and refineries use fuel oil for blending purposes.

Fuel Oil Export Sales

The following table sets forth Petrobras fuel oil export sales for the period from 2001 to 2005:

FUEL OIL EXPORT SALES

	2005	2004	2003	2002	2001
Millions of U.S.$	1,077.6	1,306.1	967.3	697.0	658.0
Millions of Barrels	25.5	47.5	38.4	30.8	31.5

Organizational Structure

All of our 19 direct subsidiaries listed below are incorporated under the laws of Brazil, except PIFCo, Petrobras International Braspetro B.V. (PIB BV), Braspetro Oil Company (BOC), Braspetro Oil Services Company (Brasoil) and Petrobras Netherlands B.V. (PNBV), which are incorporated abroad. See Exhibit 8.1 for a complete list of our subsidiaries.

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The following diagram sets forth our significant consolidated subsidiaries as of December 31, 2005:

Property, Plants and Equipment

Petrobras

Under Brazilian law, the Brazilian government owns all crude oil and natural gas reserves within Brazil, and we have certain rights to exploit those reserves pursuant to concessions. Substantially all of our property, consisting of refineries and storage, production, manufacturing and transportation facilities, is located in Brazil. Our main owned and leased tangible assets consist of our wells, our platforms, our refining facilities, our pipelines, our vessels and other transportation assets and our power plants. Some of these assets are subject to liens but the value of such encumbered assets is not material. See Item 4. Information on the Company for a description of our reserves, sources of crude oil and natural gas, main tangible assets and material plans for expansion and improvements in our facilities.

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PIFCo

PIFCo does not own or lease any material tangible properties or fixed assets. The majority of PIFCo s assets consist of leasehold improvements, computers and furniture. In January 2003, PIFCo transferred its subsidiary PNBV to us as part of our restructuring of our subsidiaries according to the areas of business each subsidiary deals in.

Regulation of the Oil and Gas Industry in Brazil

Regulatory Framework

Under Brazilian law, the Brazilian government owns all crude oil and natural gas reserves in Brazil. Additionally, Article 1 of Law No. 2,004 of 1953 granted the Brazilian government a monopoly over the research, exploration, production, refining and transportation of crude oil and oil products in Brazil and its continental shelf, subject only to the right of companies engaged in crude oil refining and the distribution of oil products at that time to continue those activities. Under Article 2 of Law No. 2,004, the Brazilian government made us its exclusive agent for purposes of exploiting the Brazilian government s monopoly. In 1988, when it enacted the current Brazilian Constitution, the Brazilian Congress incorporated Article 1 of Law No. 2,004 into the Constitution and included within the scope of the Brazilian government s monopoly the importation and exportation of crude oil and oil products.

Beginning in 1995, the Brazilian government undertook a comprehensive reform of the country s oil and gas regulatory system. On November 9, 1995, the Brazilian Congress amended the Brazilian Constitution to authorize the Brazilian government to contract with any state or privately-owned company to carry out the activities related to the upstream and downstream segments of the Brazilian oil and gas sector. Accordingly, this amendment made it possible to end our government-granted monopoly. The amendment was implemented by the enactment of the Oil Law No. 9,478, which revoked Law No. 2,004.

The Oil Law provided for the establishment of a new regulatory framework, ending our exclusive agency and enabling competition in all aspects of the oil and gas industry in Brazil. As a result of this constitutional amendment and the subsequent and ongoing implementation of the changes under the Oil Law, its amendments and related regulations, we have been operating in an environment of gradual deregulation and increasing competition.

The Oil Law also created an independent regulatory agency, the ANP. The ANP s function is to regulate the oil and natural gas industry in Brazil. A primary objective of the ANP is to create a competitive environment for oil and gas activities in Brazil that will lead to the lowest price and best services for consumers. Among its principal responsibilities is to regulate concession terms for upstream development and award new exploration concessions. See Item 10. Additional Information Material Contracts Petrobras Concession Agreements with the ANP.

The Oil Law granted us the exclusive right to exploit the crude oil reserves in all fields where we had previously commenced production, in accordance with the concession agreement entered into with the ANP on August 6, 1998. For each concession area, we were granted an exclusivity period of 27 years as of the date the field was declared to be commercially profitable.

The Oil Law also established a procedural framework for us to claim exclusive exploratory rights for a period of up to three years, which was later extended to five years, with respect to areas where we could demonstrate that we had established prospects prior to the enactment of the Oil Law. In order to perfect our claim to explore and develop these areas, we had to demonstrate that we had the required financial capacity to carry out these activities, either alone or through other cooperative arrangements.

Each year we are required to submit our capital expenditures budget for the following fiscal year to the Ministry of Planning, Budget and Management and the Ministry of Mines and Energy. Once reviewed by those offices, the capital expenditures budget is then submitted to the Brazilian Congress for approval. As a result of this process, the total level of our capital expenditures for each fiscal year is regulated, although the specific application of funds is left to our discretion. Since mid-1991, we have obtained substantial amounts of our financing from the

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international capital markets, mainly through the issuance of commercial paper and short, medium and long-term notes, and have increasingly been able to raise long-term funds for large capital expenditure items such as rigs and platforms.

Our strategic objectives and planning are subject to supervision by the Ministry of Planning, Budget and Management. Our activities are also subject to regulation by the Ministry of Finance and the Ministry of Mines and Energy, among others. In addition, since our common and preferred shares and ADSs are traded on the São Paulo Stock Exchange and the New York Stock Exchange, respectively, we are also regulated by the *Comissão de Valores Mobiliários* (Brazilian Securities Commission, or the CVM), the *Securities and Exchange Commission* and *Comisión Nacional de Valores*, or the CNV, as of April 27, 2006.

Brazil is not a member of OPEC, but we have been invited to attend OPEC meetings as an observer. Therefore, neither Brazil nor we are bound by OPEC guidelines. However, to the extent that OPEC influences international crude oil prices, our prices are affected, as our prices are linked to international crude oil prices.

Price Regulation

Since January 2, 2002, pursuant to Law No. 9,990, and as set forth below, the Brazilian government eliminated price controls for crude oil and oil products, except for the natural gas sold for qualifying gas-fired power plants. This led to increased competition and further price adjustments, as other companies were allowed to participate in the Brazilian market and import and export crude oil, oil products and natural gas to and from Brazil.

Prices remain regulated, however, for certain natural gas sales contracts and electricity.

To permit the taxation of all imported crude oil, oil products and natural gas in conjunction with the opening of the market to all participants, the Brazilian government established an excise tax to be applied with respect to the sale and import of crude oil, oil products and natural gas products (*Contribuição de Intervenção no Domínio Econômico*, Contribution for Intervention in the Economic Sector, or CIDE). Until April 30, 2004, the amounts paid as CIDE could be deducted from the payments of the PIS/PASEP and COFINS taxes.

As of May 1, 2004, important changes were made regarding the taxation of oil products sales. The amount paid as CIDE that can be deducted from PIS (*Programa de Integração Social*)/PASEP (Programa de Formação do Patrimônio do Servidor Público) and COFINS (*Contribuição para o Financiamento da Seguridade Social*) was reduced to zero. The PIS/PASEP tax and the COFINS tax previously ad valorem taxes on imported products were converted into specific value taxes, and the CIDE tax was changed to the following rates:

Product	**PIS/PASEP and COFINS rate (*reais*/m3, except LPG/metric ton)**	**CIDE**
Gasoline	R$261.60	280.0
Diesel	148.00	70.0
Jet Fuel	71.20	
LPG	167.70	

For certain trading transaction, the taxpayer may still opt to pay the PIS/PASEP tax and the COFINS as ad valorem taxes.

Since the implementation of the Oil Law in 1997 and through December 31, 2001, the Brazilian oil and gas sector was significantly deregulated and the Brazilian government changed its price regulation policies. Under these regulations, the Brazilian government:

- introduced a new methodology for determining the price of oil products designed to track prevailing international prices and the *real*/U.S. dollar exchange rate;

- eliminated regulation of the cost at which we could record imported crude oil and oil products in our cost of sales;

- gradually eliminated controls on wholesale prices at which we could sell our oil products, except for diesel, gasoline and LPG;

- effective July 28, 1998, eliminated transportation cost equalization subsidies known as *Frete para Uniformização de Preços* (Freight for the Uniformity of Prices, or FUP), in the case of transportation subsidies for oil products, and *Frete para Uniformização de Preços do Álcool* (Freight for the Uniformity of Prices of Alcohol, or FUPA), in the case of transportation subsidies for fuel alcohol; and

- continued to require that we act as the Brazilian government s administrator for the fuel alcohol program.

Until the passage of the Oil Law 9,478 in 1997, the Brazilian government had the power to regulate all aspects of the pricing of crude oil, oil products, fuel alcohol and other energy sources in Brazil, including natural gas and energy.

Crude Oil and Refined Oil Products

Pursuant to the Oil Law and subsequent legislation as per Law No. 10,336 dated December 19, 2001., the oil and gas markets in Brazil underwent regulatory change beginning January 2, 2002. As part of this action:

- the Brazilian government no longer set sales prices for crude oil and oil products; and

- the Brazilian government established CIDE, an excise tax payable to the Brazilian government required to be paid by producers, blenders and importers upon sales and purchases of specified oil and fuel products at a set amount for different products based on the unit of measurement typically used for such products.

Until enactment of the Oil Law, the Brazilian government regulated all aspects of the pricing of crude oil and oil products in Brazil, from the cost of crude oil imported for use in our refineries, to the price of refined oil products charged to the consumer.

Natural Gas

Starting in January 2002, price controls on natural gas prices in Brazil were eliminated. Some contracts that were signed under the old system of price controls are still in force, but new contracts must contain clauses ensuring that prices are freely negotiated amongst the parties.

The Petroleum and Alcohol Account Certification t and Settlement

As provided in the Oil Law 9,478, the fuel market in Brazil was freed of price controls as of January 1, 2002, permitting other companies to produce and sell on the domestic market and, also, import and export oil and oil products. Additionally, as of January 1, 2002, we were no longer required to charge the prices established by the Brazilian government on the sale of oil products, and the realization price is no longer established by a formula adjusted to the international market.

Considering the liberation of the market and current legislation, as of January 1, 2002, the Petroleum and Alcohol Account is no longer used to reimburse expenses related to the supply of oil products and fuel alcohol to us and third parties. The movements in the account for periods after 2002 relate only to (i) payments and adjustments mandated by the Agência Nacional do Petróleo ANP with no impact on the income statement and (ii) adjustments resulting from the audit of the account by the ANP.

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The ANP/STN Integrated Audit Committee submitted, on June 23, 2004, its final report certifying and approving the balance of the Petroleum and Alcohol account. The conclusion of this audit process for the Petroleum and Alcohol account establishes the basis for concluding the settlement process between the Brazilian government and us.

As defined in Law No. 10,742 dated October 06, 2003, the settlement of the Petroleum and Alcohol account with the Brazilian government should have been completed by June 30, 2004. We have been working with the Ministry of Mines and Energy MME and Secretary of the National Treasury STN in order to resolve remaining issues necessary to conclude the settlement process.

To facilitate the required settlement, on June 30, 1998, the Brazilian government issued National Treasury Bonds-Series H to us, representing the credit owed to us by the Brazilian government from the Petroleum and Alcohol Account. The bonds were placed with a federal depositary to support the balance of this account.

The National Treasury Bonds-Series H matured on June 30, 2004. As of June 30, 2004, there were 138,791 National Treasure Bonds-Series H outstanding in the amount of U.S.$56 million against the balance of the Petroleum and Alcohol Account was U.S.$241 million. On July 2, 2004, the Brazilian Government made a deposit in an account in our name of U.S.$56 million for payment of the bonds. However, only U.S.$3 million of this amount was made available to us. We do not have access to the remaining U.S.$53 million, which represent a partial guarantee of the balance of the Petroleum and Alcohol Account, according to the determination of the Secretaria do Tesouro Nacional (STN). The legal, valid and binding nature of the account is not affected by any difference between the balance of the account and the value of the outstanding bonds.

The remaining balance of the Petroleum and Alcohol account may be paid as follows: (1) National Treasury Bonds issued at the same amount as the final balance of the Petroleum and Alcohol account; (2) offset of the balance of the Petroleum and Alcohol account, with any other amount we owed to the Brazilian Government, including taxes; or (3) by a combination of the above options.

The following table summarizes the changes in the Petroleum and Alcohol Account for 2005, 2004 and 2003:

	For the Year Ended December 31,		
	2005	2004	2003
	(in millions of U.S. dollars)		
Opening balance	$ 282	$ 239	$ 182
Reimbursements to third parties: subsidies paid to fuel alcohol producers			5
Reimbursements to Petrobras: transport of oil products		1	
Financial income	9	4	10
Results of certification/audit process conducted by the Brazilian government		16	
Partial settlement		(3)	
Translation gain (loss)(1)	38	25	42
Ending balance	$ 329	$ 282	$ 239

(1) Exchange rate translation gains (losses) are recorded as a component of cumulative translation adjustments.

The U.S.$47 million increase in the balance of the Petroleum and Alcohol Account during 2005 was primarily a result of the 11.8% appreciation of the *real* against the U.S. dollar.

Exploration and Development Regulation

During the time we had a government-granted monopoly in Brazil for oil and gas operations, we had the right to exploit all production, exploration and development areas in Brazil. When government-granted monopoly

was terminated, the Brazilian government was allowed to contract with any state or privately owned company for the development of the upstream and downstream segments of the Brazilian oil and gas sector. Before establishing bidding rounds for concessions, the Brazilian government granted us the exclusive right to exploit crude oil reserves where we had previously commenced operations. In 1998, the ANP started to conduct bidding rounds to grant concessions for production, exploration and development areas, and we were required to compete for concessions.

With the effectiveness of the Oil Law and the regulations promulgated by the ANP thereunder, concessionaires are required to pay the government the following:

- signature bonuses;
- rentals for the occupation or retention of areas;
- special participation; and
- royalties.

The minimum signature bonuses are published in the bidding rules for the concessions being auctioned, but the actual amount is based on the amount of the winning bid and must be paid upon the execution of the concession agreement.

The rentals for the occupation and retention of the concession areas are determined for in the related bidding rules and are payable annually. For purposes of calculating rentals, the ANP takes into consideration factors such as the location and size of the relevant concession block, the sedimentary basin and its geological characteristics.

Special participation is an extraordinary charge we must pay in the event of high production volumes and/or profitability from our fields, according to criteria established by applicable regulation, and is payable on a quarterly basis for each field from the date on which extraordinary production occurs. This participation rate, whenever it is due, varies between 0% and 40% depending on:

- volume of production; and
- whether the block is onshore or offshore and, if offshore, whether it is shallow or deep water.

Under the Oil Law and applicable regulations, the special participation is calculated based upon quarterly net revenues of each field, which consist of gross revenues calculated using reference prices published by the ANP (reflecting international prices and the exchange rate) less:

- royalties paid;
- investment in exploration;
- operational costs; and
- depreciation adjustments and applicable taxes.

The ANP is also responsible for determining monthly royalties payable with respect to production. Royalties generally correspond to a percentage ranging between 5% and 10% applied to reference prices for oil or natural gas, as established in the relevant bidding guidelines (*edital de licitação*) and concession contract (*contrato de concessão*). Virtually all of our production currently pays the maximum 10% rate. In determining the royalties applicable to a particular concession block, the ANP takes into consideration, among other factors, the geological risks involved and the production levels expected.

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The Oil Law also requires concessionaires of onshore fields to pay to the owner of the land a special participation fee that varies between 0.5% and 1.0% of the net operating revenues derived from the production of the field.

Environmental Regulations

All phases of the crude oil and natural gas business present environmental risks and hazards. Our facilities in Brazil are subject to a wide range of federal, state and local laws, regulations and permit requirements relating to the protection of human health and the environment. At the federal level, our offshore activities and those which involve more than one state of the Federation are subject to the administrative authority of the Brazilian Institute for the Environment and Renewable Natural Resources, or IBAMA, and to the regulatory authority of the *Conselho Nacional do Meio Ambiente* (National Council for the Environment), which issues operating or drilling licenses. Maintenance of the licenses requires the submission of reports, including safety and pollution monitoring reports (IOPP) to IBAMA. Onshore environmental, health and safety conditions are controlled at the state rather than federal level. Law No. 6,938 of August 31, 1981, and subsequent regulations and decrees established strict liability for environmental damage, mechanisms for enforcement of environmental standards and licensing requirements for polluting activities.

CONAMA s Resolution No. 23 of 1994 requires us to conduct environmental studies in connection with a number of our activities. We must eliminate, mitigate, or compensate relevant parties for, any adverse environmental effects identified through these studies.

On December 27, 2000, Law No. 10,165, modifying Law No. 6,938, created the *Taxa de Controle e Fiscalização Ambiental* (Environmental and Fiscalization Control Tax, or TCFA). The law empowers IBAMA to collect, on a quarterly basis, certain fees from us and other companies that meet a minimum revenue threshold, are engaged in potentially environmentally damaging activities and/or are exploiting natural resources within Brazil. At present, we do not consider this fee imposed by IBAMA to be material. The *Confederação Nacional da Indústria* (Brazilian Industry Confederation, or CNI), is currently contesting these fees as unconstitutional.

Brazilian environmental laws and regulations provide for restrictions and prohibitions on spills and releases or emissions of various hazardous substances produced in association with our operations. Brazilian environmental laws and regulations also govern the operation, maintenance, abandonment and reclamation of wells, refineries, terminals, service stations and other facilities. Compliance with these laws and regulations can require significant expenditures, and violations may result in fines and penalties, some of which may be material. In addition, operations and undertakings that have a significant environmental impact, especially the drilling of new wells and expansion of refineries, require us to apply for environmental impact assessments in accordance with federal and state licensing procedures. In accordance with Brazilian environmental laws, we have proposed the execution of, or we have entered into, environmental commitment agreements with the environmental protection agencies and/or the federal or state public ministries, in which we agree to undertake certain measures in order to complete the environmental licensing for several of our operating facilities.

Under Law No. 9,605 of February 12, 1998, individuals or entities whose conduct or activities cause harm to the environment are subject to criminal and administrative sanctions, as well as any costs to repair the actual damages resulting from such harm. Individuals or legal entities that commit a crime against the environment are subject to penalties and sanctions that range from fines to imprisonment, for individuals, or, suspension or interruption of activities or prohibition to enter into any contracts with governmental bodies for up to ten years for legal entities. The government environmental protection agencies may also impose administrative sanctions on those who do not comply with the environmental laws and regulations, including, among others:

- fines;
- partial or total suspension of activities;
- obligations to fund recovery works and environmental projects;

- forfeiture or restriction of tax incentives or benefits;
- closing of the establishments or undertakings; and
- forfeiture or suspension of participation in credit lines with official credit establishments.

Under Law No. 9,966 of 2000, entities operating organized ports and port installations and owners or operators of platforms and its support installations must perform independent environmental audits every two years, with a view to evaluating the environmental management and control systems in their units. We are in full compliance with this law.

Law No. 9,985 of July 19, 2000 establishes an environmental compensation of at least 0.5% of the value of a project relating to activities that have a negative environmental impact that cannot be mitigated. This compensation may only be applied in conservation units, as defined by the Sistema Nacional de Unidades de Conservação da Natureza (the National System of Nature Conservation Units, or the SNUC). Environmental agencies are still implementing this law, but they may attempt to apply it in a retroactive manner.

In 2005, we invested approximately U.S$430 million in environmental projects as compared to approximately U.S.$490 million in 2004. These investments were primarily directed at reducing emissions and wastes resulting from industrial processes, managing water use and effluents, remedying impacted areas, obtaining oil collectors for our environmental protection centers and other new equipment to improve our response to emergency situations, implementing new environmental technologies, upgrading our pipelines and paying environmental compensation.

In March 2006, the Brazilian Congress enacted Law No. 11,284, which, among other things, creates the concept of environmental insurance as an economic policy instrument. Brazilian companies will be required to purchase environmental insurance only once the Brazilian Congress approves a new law to regulate Law No. 11,284 that expressly creates this obligation. We do not know the terms and conditions under which environmental insurance will be contracted in the future and, therefore, we cannot estimate whether the requirement to purchase environmental insurance will have a material adverse effect in our business, financial condition and results of operations.

We are subject to a number of administrative proceedings and civil and criminal claims relating to environmental matters. See Item 8. Financial Information Legal Proceedings Environmental Claims.

Health, Safety and Environmental Initiatives

Initiatives

The protection of human health and the environment is one of our primary concerns, and is essential to our success as an integrated energy company. In order to address and prioritize health, safety and environmental concerns and ensure compliance with environmental regulations, we have:

- developed the PEGASO program to upgrade our pipelines and other equipment, implement new technologies, improve our emergency response readiness, reduce emissions and residues and prevent environmental accidents. From April 2000 to December 2005, we spent approximately U.S$3.519 billion under this program, including the *Programa de Integridade de Dutos* (Pipeline Integrity Program) through which we conduct inspections of, and improvements to, our pipelines. In 2005, we spent approximately U.S$545 million in connection with the PEGASO program;
- proposed the execution of, or entered into, environmental commitment agreements with several environmental protection agencies and/or the federal or state public ministries, in which we agree to undertake certain measures in order to complete the environmental licensing for several of our operating facilities;

integrated our corporate health department into the already existing corporate environment and safety department, thereby facilitating the development of systematic, company-wide procedures to handle concerns related to health, safety and the environment, or HSE.

established our new HSE policy and corporate guidelines, which focus on principles of sustainable development, compliance with legislation and the availability and use of environmental performance indicators;

undertook capital investments to reduce the HSE risk of our operations, including making improvements to our refineries and transportation facilities and developing and implementing oil pollution prevention guidelines;

built nine environmental protection centers and seven advanced bases for oil spill prevention, control and response, established local and regional, onshore and offshore contingency plans involving public services and communities to deal with oil spills, and chartered three dedicated oil spill recovery vessels (OSRVs) fully equipped for oil spill control and fire fighting;

received HSE integrated management certificates for our operating units. As of December 2005, Petrobras owned 45 certificates for its operating units in Brazil and 21 for units abroad. These certificates acknowledge the compliance of our HSE management system with ISO 14001 (environment), and BS 8800 or OHSAS 18001 (health and safety) standards. Because some of those certificates cover more than one site, the total number of certified sites is 172 in Brazil and 25 abroad. The *Frota Nacional de Petroleiros* (National Fleet of Vessels) has been fully certified by the IMO International Management Code for Safe Operation of Ships and for Pollution Prevention (ISM Code) since December 1997;

implemented through the Programa de Segurança de Processo (Process Safety Program) standardized, company-wide guidelines for HSE management, for effectively investigating incidents and for strengthening our institutional commitment to HSE through employee training. The HSE Management Manual developed through that program is a day-to-day management tool currently being applied in all of our operating units;

developed an Air Emissions Management System, in conjunction with an international consulting company, for our operations in Brazil and South America. The system gathers information about emissions of sulfur dioxide, nitrogen oxides, carbon monoxide, the main greenhouse gases (carbon dioxide, methane and nitrous oxide), volatile organic compounds (VOCs) and particulate material, allowing us to improve the management of our emissions. We have registered our 2004 Annual Emissions Summary in the Global Greenhouse Gas Register of the World Economic Forum. The report gathers data provided by the Air Emissions Management System and is available for public access through the Forum s website;

participated in negotiations conducted by the Brazilian Ministry of Mines and Energy of new regulations of environmental compensation related to the implementation of new projects;

participated with the Brazilian Ministry of Mines and Energy and IBAMA in a governmental follow-up group created to supervise the implementation of the new planned gas pipelines;

participated regularly in the discussion agenda of the Brazilian Ministry of Mines and Energy and the Ministry of the Environment about environmental issues affecting our business;

participated directly in discussions with the Ministry of the Environment and IBAMA regarding issues that could affect Petrobras business;

In addition, we conduct environmental studies for all new projects as required by Brazilian environmental legislation, and our HSE department evaluates each and every project with a total budget exceeding U.S$25 million to confirm its compliance with all HSE requirements.

We will continue to evaluate and develop initiatives to address HSE concerns and to reduce our exposure to HSE risks.

Our Executive Board has approved the building of three biodiesel production plants, with a total capacity of 132,000 tons per year. The plants will demand an investment of about U.S.$86.6 million and are expected to begin operations in December of 2007;

We have bought 70,000 cubic meters of biodiesel, certified with the social fuel label, to be delivered throughout 2006. Social fuel is fuel manufactured under a government program designed to promote family-run agricultural enterprises;

Petrobras Distribuidora is going to participate in the construction of 13 small hydropower plants (SHPs), with a total capacity of 288 MW. The project was already approved by the National Agency for Electrical Energy, under the Brazilian Program for Incentive to Alternative Electric Energy Sources PROINFA, and will demand an investment of about (R$1.3 billion). The SHPs will be controlled by a holding company named Brasil PCH. 49% of the common shares of that company will be owned by Petrobras Distribuidora.

Management

We have a HSE Management Committee, which was created by our executive officers to ensure that HSE issues are addressed throughout the company. The committee is composed of executive managers of our different business segments and of directors of our controlled companies, BR Distribuidora and Transpetro. The work of the HSE Management Committee is supported by four permanent subcommittees and by temporary commissions and work groups, each one responsible for a specific HSE issue, such as licensing and environmental compensation, operational risk assessment, management of change, emissions and climate change, new projects, product stewardship and acquisition of goods.

We have also created an Environmental Committee, which is composed of three members of our Board of Directors, including our Chairman and our Chief Executive Officer. The committee is responsible for, among other things: (1) overseeing and managing environmental and work safety issues affecting us; (2) establishing measurable environmental targets and ensuring compliance; and (3) recommending changes in environmental, health and safety policy, if necessary, to our board of directors. The Environmental Committee charter is still subject to approval by our Board of Directors.

Competition

As a result of the regulatory reform of the oil and gas industry in Brazil, we expect to face increasing competition both in our downstream and upstream operations.

In the exploration and production segment, the Brazilian government s auction process for new exploratory areas has enabled multinational and regional oil and gas companies to begin exploring for crude oil in Brazil. If these companies discover crude oil in commercial quantities and are able to develop it economically, we expect that competition with our own production will increase.

In the past, we have faced little competition as a result of the prevailing laws that effectively gave us a monopoly. With the end of this monopoly and regulatory reform, other participants may now explore, produce, transport and distribute oil products in Brazil. As a result, some participants have already begun importing refined oil products, which will compete with oil products from our Brazilian refineries, as well as the oil products we currently import. We now have to compete with global imports at international prices. We expect that this additional competition may affect the prices we can charge for our oil products, which in turn will affect the profit we can make. We estimate that we had a market share of approximately 98.2% in the Brazilian oil production segment in

2005. We do not have meaningful competitors in the oil production segment in Brazil. In the oil exploration segment, we estimate that the exploration activities conducted solely by us represented approximately 88% (number of exploration wells we drilled solely compared to the total number of exploration wells drilled in Brazil in 2005) of the Brazilian oil exploration market in 2005 and the exploration activities conducted by us in conjunction with other partners represented approximately 92% (number of exploration wells we drilled solely and with partners compared to the number of exploration wells drilled in Brazil in 2005) of the oil exploration market in Brazil in 2005. Our main competitors in the oil exploration segment are Agip, Devon, Shell, Maersk, Statoil, Chevron Texaco, Encana and El Paso.

We also expect continued competition in our distribution segment, where we currently face the most significant competition of any of our business segments. In particular, we face competition from small distributors, many of which have been able, and may continue to be able, to avoid paying sales taxes and mix their gasoline with inexpensive solvents, enabling them to sell gasoline at prices below ours. We had a market share of approximately 34 % in the Brazilian oil products distribution segment according to Sindicom, a Brazilian industry association of oil and gas distribution companies. Our main competitors in this segment are Ipiranga, Shell, Esso, and Texaco.

In the natural gas and power segment, we expect competition from new entrants that are acquiring interests in natural gas distribution and gas-fired power generation companies, and existing competitors that are expanding operations in order to consolidate their position in Brazil. We had a market share of approximately 94% in the Brazilian natural gas segment based on 2005 volumes sold to the Local Distribution Companies and total natural gas market, according to the *Associação Brasileira das Empresas de Gás Natural* (the Brazilian Society of Natural Gas Companies, or ABEGÁS).

In the international segment, we plan to continue expanding operations, although we expect to face continuing competition in the areas in which we are already active, including the Gulf of Mexico, Africa and the Southern Cone. We have already become a major player in some of the countries in which we have international operations. In Argentina, we estimate that we have a market share of 13.3% for auto fuel and 10.4% for lubricants. In Bolivia, we have a market share of 96% of the oil refining market, 40.6% of the fuel market, and 66% of lubricants.

Insurance

Our insurance programs principally focus on the concentration of risks and the importance and replacement value of assets. Under our risk management policy, risks associated with our principal assets, such as refineries, tankers, our fleet and offshore production and drilling platforms, are insured for their replacement value with third-party Brazilian insurers. Although the policies are issued in Brazil, most of our policies are reinsured abroad with reinsurers rated BBB+ or higher by Standard & Poor s rating agency or B++ or higher by A.M. Best. Substantially all of our international operations are insured or reinsured by our Bermudian subsidiary Bear Insurance Company Limited following exactly the same rating criteria.

Less valuable assets, such as small auxiliary boats, certain storage facilities, and some administrative installations, are self-insured. We do not maintain coverage for business interruption, except for a minority of our international operations. We also do not maintain coverage for our wells for substantially all of our Brazilian operations.

Since November 2000, we maintain coverage for operational third-party liability with respect to our onshore and offshore activities, including environmental risks such as oil spills. The insurance policy covers any damage resulting from either our or our affiliates activities, with the exception of our international activities, which have their own insurance and are therefore not included in this policy. In Brazil, our coverage in this policy is of up to U.S.$250 million per accident in the aggregate (fines imposed by government authorities are not covered). In case of an accident, this coverage may not be sufficient to compensate us for losses incurred. Although we do not insure most of our pipelines, we have insurance against damage or loss resulting from specific incidents, as well as oil pollution from our pipelines.

We also maintain coverage for risks associated with transportation, hull and machinery risk. Since 1999, we have directors and officers insurance coverage. All projects and installations under construction are insured in

compliance with the terms of the relevant financing agreements, usually through a performance bond in connection with completion of the contract and/or other damage and liability insurance. All projects and installations under construction that have an estimated maximum loss above U.S.$40 million are covered by a construction policy.

The premium for renewing our property risk insurance policy for a 12-month period commencing June 2005 was U.S$29.4 million. This represented an increase of 16.5% over the preceding 12-month period. The increase was primarily due to an increase in the insured value of our assets, which in the same period, increased by 22.9%, from U.S.$26.6 billion to U.S$32.7 billion. Since 2001, our risk retention has increased and our deductibles may reach U.S.$40 million in certain cases.

Our facilities are regularly subject to risk surveys undertaken by international risk consultants. The reports and recommendations prepared in these surveys are made public, as well as the actions taken by us to meet these recommendations. All the significant accidents and their causes, as well as the improvements we make to our HSE standards are periodically released to the public.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

Management s Discussion and Analysis of Petrobras Financial Condition and Results of Operations

You should read the following discussion of our financial condition and results of operations together with our audited consolidated financial statements and the accompanying notes beginning on page F-1 of this annual report.

Overview

We earn income from:

- domestic sales, which mainly consists of sales of oil products (such as gasoline, diesel oil, jet fuel, fuel oil, naphtha and liquefied petroleum gas), natural gas, petrochemical products and electricity;
- export sales, which consist primarily of sales of crude oil and oil products;
- international sales (excluding export sales), which consist of sales of crude oil, natural gas and oil products that are produced and refined abroad; and
- other sources, including services, investment income and foreign exchange gains.

Our expenses include:

- costs of sales (which is comprised of labor expenses, costs of operating and purchases of crude oil and oil products); maintaining and repairing property, plants and equipment; depreciation and amortization of fixed assets and depletion of oil fields; and costs of exploration;
- selling (which include expenses for transportation and distribution of our products), general and administrative expenses; and
- interest expense and foreign exchange losses.

Year to year fluctuations in our income are the result of a combination of factors, including:

- the volume of crude oil, oil products and natural gas we produce and sell;
- changes in international prices of crude oil and oil products, which are denominated in U.S. dollars;
- related changes in domestic prices of crude oil and oil products, which are denominated in *reais*;
- fluctuations in the *real*/U.S. dollar and Argentine Peso/U.S. dollar exchange rates;
- Brazilian political and economic conditions; and

the amount of taxes and duties that we are required to pay with respect to our operations, by virtue of our status as a Brazilian company and our involvement in the oil and gas industry.

Sales Volumes and Prices

The profitability of our operations in any particular accounting period is related to the sales volume of, and prices for, the crude oil, oil products and natural gas that we sell. Our consolidated net sales in 2005 totaled approximately 1,025,033 million barrels of crude oil equivalent, representing U.S.$56,324 million in net operating revenues, as compared to approximately 989,719 million barrels of crude oil equivalent, representing U.S.$38,428 million in net operating revenues in 2004 and approximately 923,482 million barrels of crude oil equivalent and U.S.$30,914 million in net operating revenues in 2003.

As a vertically integrated company, we process most of our crude oil production in our refineries and sell the refined oil products primarily in the Brazilian domestic market. Therefore, it is oil product prices, rather than crude oil prices, that most directly affect our financial results.

Oil product prices vary over time as the result of many factors, including the price of crude oil. The average prices of Brent crude, an international benchmark oil, were approximately U.S.$54.38 per barrel in 2005, U.S.$38.21 per barrel for 2004 and U.S.$28.84 per barrel for 2003. For December 2005, Brent crude oil prices averaged U.S.$56.63 per barrel, but during 2006 through April, Brent crude oil prices have increased, averaging U.S.$64.03 per barrel. This increase in average crude oil prices also affected international prices for oil products.

Domestic Sales Volumes and Prices

During 2005, approximately 72.4% of our net operating revenues were derived from sales of crude oil and oil products in Brazil, as compared to 73.2% in 2004 and 74.0% in 2003. As export volumes of crude oil and oil products have increased, domestic sales as a percentage of net operating revenues have declined.

Our revenues are principally derived from sales in Brazil. The following table sets forth our sales by volume of oil products, natural gas and fuel alcohol for each of 2005, 2004 and 2003 as well as a reconciliation to our consolidated sales:

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	For the Year Ended December 31,								
	2005			2004			2003		
	Volume (Mbbl, except as otherwise noted)	Net Average Price (U.S.$)(1)	Net Operating Revenues (U.S.$ in millions)	Volume (Mbbl, except as otherwise noted)	Net Average Price (U.S.$)(1)	Net Operating Revenues (U.S.$ in millions)	Volume (Mbbl, except as otherwise noted)	Net Average Price (U.S.$)(1)	Net Operating Revenues (U.S.$ in millions)
Energy products:									
Automotive gasoline	104,901	$ 60.08	$ 6,302	100,712	$ 41.58	$ 4,188	94,364	$ 38.28	$ 3,612
Diesel	242,831	68.20	16,561	240,237	44.64	10,725	219,622	40.64	8,925
Fuel oil	36,243	40.81	1,479	39,654	28.45	1,128	43,475	27.92	1,214
Liquid petroleum gas	77,891	34.55	2,691	76,982	28.14	2,166	73,575	27.07	1,992
Total energy products	461,866		27,033	457,585		18,207	431,036		15,743
Non-energy products:									
Petrochemical naphtha	57,281	53.49	3,064	57,595	42.28	2,435	57,291	32.03	1,835
Others	80,953	58.35	4,724	77,652	41.96	3,258	73,901	33.69	2,490
Total non-energy products	138,234		7,788	135,247		5,693	131,192		4,325
Fuel alcohol	126	23.81	3	455	30.77	14	458	39.30	18
Natural gas (BOE)	83,090	21.77	1,809	77,310	18.61	1,439	64,517	18.94	1,222
Sub-total	683,316	53.61	36,633	670,597	37.81	25,353	627,203	33.97	21,308
Distribution net sales	201,347	78.53	15,811	182,327	57.36	10,458	158,635	50.39	7,994
Intercompany net sales	(187,268)	62.22	(11,651)	(164,730)	46.69	(7,692)	(143,339)	44.81	(6,423)
Total domestic market	697,395	58.49	40,793	688,194	40.86	28,119	642,499	35.61	22,879
Export net sales	187,008	47.79	8,938	186,221	31.81	5,923	192,545	27.71	5,335

International net sales and Others	140,630	43.93	6,178	115,304	35.33	4,074	88,438	29.89	2,643
Sub-Total	327,638	46.14	15,116	301,525	33.15	9,997	280,983	28.39	7,978
Services			415			312			57
Consolidated net sales	1,025,033		$ 56,324	989,719		$ 38,428	923,482		$ 30,914

(1) Net average price calculated by dividing net sales by the volume for the year.

During 2005, we announced one increase in gasoline and diesel prices due to the elevated prices of crude oil and oil products on the international market. The price increases in the table below reflect the increases in billing at Petrobras refineries, without ICMS:

Price increase announced on September 9, 2005:

	Percentage Increase in Price	
	(increase to customers including taxes(CIDE / PIS / COFINS))	**(net increase to Petrobras)**
Gasoline	16.4%	10.0%
Diesel	14.8%	12.0%

Export Sales Volumes and Prices

While our principal market is the Brazilian market, as our domestic production of crude oil has increased, we have begun to export greater amounts of crude oil and oil products that exceed Brazilian demand. We also export volumes of domestically produced heavy crude oil that our refineries are unable to process operationally or economically. See Item 4. Information on the Company Refining, Transportation and Marketing. Our export volumes of crude oil and oil products totaled 187,008 million barrels of crude oil equivalent in 2005, as compared to 186,221 million barrels of crude oil equivalent in 2004 and 192,545 million barrels of crude oil equivalent in 2003. We base our crude oil export prices on international prices, as adjusted to reflect specific market conditions. We determine export prices of our oil products and natural gas by reference to market conditions, as well as direct

negotiations with our clients. As a result of an increase in average prices and volume of export sales of crude oil and oil products, the total value of our crude oil and oil product exports (measured on a free-on-board basis) in 2005 was U.S.$ 8,938 million, as compared to U.S.$5,923 million in 2004 and U.S.$5,335 million in 2003, representing approximately 15.9% of our net operating revenues in 2005, as compared to 15.4% in 2004 and 17.3% in 2003. See Item 4. Information on the Company Refining, Transportation and Marketing-Exports.

International Volumes and Prices

We produce, refine, transport, distribute and market crude oil and natural gas internationally. Sales from production outside Brazil to sources outside Brazil were U.S.$3,038 million in 2005, U.S.$2,840 million in 2004 and U.S.$1,974 million in 2003, representing approximately 5.4% of our net operating revenues in 2005, as compared to 7.4% in 2004 and 6.4% in 2003. We expect our international sales to continue growing as our international production continues to grow and we increase our refining and distribution capacity abroad. See Item 4. Information on the Company International.

Import Purchase Volumes and Prices

We continue to import lighter crude oil for blending in our own refineries, as well as smaller quantities of diesel, liquefied petroleum gas, naphtha and other oil products, to attend the demand of the Brazilian retail market. We have continuously upgraded our refineries to handle heavier crude oil in order to reduce our purchases of imported crude oil and oil products by refining a greater portion of our heavier crude oil production. This has positively affected the margin between our net operating revenues and cost of goods sold, since it is less expensive to produce crude oil domestically than it is to import crude oil. In 2005, the net margin increased to 18.4% as compared to 16.1% in 2004, as a result of a decrease in imported crude oil to 352 Mbpd in 2005, from 450 Mbpd in 2004.

Prior to December 31, 2001, we were the only company permitted to import oil products to supply the Brazilian market s demand for these products. Now that other parties are permitted by law to import oil products and supply the market, we continue to reevaluate our strategy in order to achieve optimal levels of imports for our profitability. We imported a total of 34.8 million barrels of oil products in 2005, as compared to 40.1 million barrels of oil products in 2004 and 44.5 million barrels in 2003. See Item 4. Information on the Company Refining, Transportation and Marketing-Imports.

Effect of Taxes on our Income

General

In addition to taxes paid on behalf of federal, state and municipal governments, such as the Imposto sobre Circulação de Mercadorias e Serviços, or ICMS, we are required to pay three principal charges on our oil production activities in Brazil:

Royalties, which generally correspond to a percentage between 5% and 10% of production, are calculated based on a reference price for crude oil or natural gas, and will thus vary with the international price of crude oil. The ANP also takes into account the geological risks involved, and productivity levels expected, with respect to a particular concession. Virtually all of our crude oil production is currently taxed at the maximum royalty rate.

Special Participation, which applies to our larger, more profitable fields, and ranges from 0% to 40% depending on the volumes of crude oil produced in the fields, the location of the fields (including whether they are onshore or offshore), water depth and number of years that the field has been in production. In 2005, the tax was charged on 20 of our fields, including Marlim, Albacora, Roncador, Leste do Urucu, Rio Urucu, Canto do Amaro, Marimbá, Marlim Sul, Namorado, Carapeba, Pampo, Bicudo, Barracuda, Caratinga, Cherne, Pilar, Fazenda Alegre, Miranga, Carmópolis and Bijupirá. The tax is based on net revenues of a field, which consists of gross revenues less royalties paid, investments in exploration, operational costs and depreciation adjustments and applicable taxes. The Special Participation Tax uses as a reference international oil prices converted to *reais* at the current exchange rate.

Retention Bonus, which is a tax payable on those concessions that are available for exploration and production, and is calculated at a rate established by the ANP, taking into consideration factors such as the location and

size of the relevant concession block, the sedimentary basin and its geological characteristics.

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These charges imposed by the Brazilian government are included in our cost of goods sold. Additionally, we are subject to tax on our income at an effective rate of 25% and a social contribution tax at an effective rate of 9%, the standard corporate tax rate in Brazil. See Note 4 to our audited consolidated financial statements.

Potential Change in ICMS Legislation

In June 2003, the State of Rio de Janeiro enacted a law (State Law nº 4.117, dated June, 27th, 2003, also known as Noel Law) imposing the ICMS on upstream activities. The law was regulated by Decree nº 34.761, dated February 3, 2004, which was suspended by Decree nº 34.783 of February 4th, 2004, for an undetermined period of time. Nevertheless, the State of Rio de Janeiro may choose to enforce the law at any time.

The constitutionality of this law is currently being challenged. The claim was filed by the Federal Prosecutor and the Attorney General has given a favorable legal opinion. The Supreme Court provisionally did not suspend the effectiveness of the law.

In accordance with legislation currently in force, the ICMS for fuels derived from oil is assessed at the point of sale but not at the wellhead level. As a result, the tax is mainly collected in the states where the sales of fuels are made. If the State of Rio de Janeiro enforces the new law, it is unlikely that the other states would allow us to use the tax imposed at the wellhead level in Rio de Janeiro as a credit to offset the tax imposed at the sale level. Therefore, we would have to pay ICMS at both levels, unless we are successful in challenging this tax in court. If the Supreme Court decides that this law is constitutional, our ability to challenge the payment of ICMS at both levels will depend on the ground of the Supreme Court s decision.

We estimate the amount of ICMS that we would be required to pay to the State of Rio de Janeiro could increase by approximately R$8.51 billion (U.S.$3.52 billion) per year as a result of this change in legislation. This increase could have a material adverse effect on our results of operations and financial condition.

Financial Income and Expense

We derive financial income primarily from interest on cash and cash equivalents. The bulk of our cash equivalents are short-term Brazilian government securities, including securities indexed to the U.S. dollar. We also hold substantial balances in U.S. dollar deposits.

Our financial income was U.S.$710 million in 2005, U.S.$956 million in 2004 and U.S.$634 million in 2003.

We incur financial expenses from short and long-term debt denominated in U.S. dollars, *reais* and other currencies. Our financial expenses were U.S.$1,189 million in 2005, U.S.$1,733 million in 2004 and U.S.$1,247 million in 2003. In addition, we capitalized U.S.$612 million in interest in 2005, as compared to U.S.$267 million in 2004 and U.S.$184 million in 2003.

Inflation and Exchange Rate Variation

Inflation

Since the introduction of the *real* as the new Brazilian currency in July 1994, inflation in Brazil has remained relatively stable, although it increased markedly in 2002. Inflation was 1.2% in 2005, 12.1% in 2004 and 7.7% in 2003, as measured by the IGP-DI, a general price index. Inflation has had, and may continue to have, effects on our financial condition and results of operations. A large percentage of our total costs are in Reais, and our suppliers and service providers generally attempt to increase their prices to reflect Brazilian inflation. These increases are counteracted by the adjustments that we make to our prices to offset the effects of inflation and an appreciation of the U.S. dollar against the *real*.

Exchange Rate Variation

Since we adopted the *real* as our functional currency in 1998, fluctuations in the value of the *real* against the U.S. dollar, particularly devaluations of the *real*, have had, and will continue to have, multiple effects on our results of operations. Our reporting currency for all periods is the U.S. dollar. We maintain our financial records in *reais*,

and translate our statements of operations into U.S. dollars at the average rate for the period. The amounts reported in our statements of operations in any given period will be reduced at the same rate as the *real* has devalued in relation to the U.S. dollar during that period. During 2005, there was an 11.8% appreciation of the *real* against the U.S. dollar, as compared to an 8.1% appreciation in 2004 and an 18.2% depreciation in 2003.

Virtually all of our sales are of crude oil or oil products, which generally trade freely in the international markets at prices expressed in U.S. dollars. From July 1998 through the end of 2001, our net operating revenues reflected changes in the U.S. dollar/*real* exchange rate, with a one month delay, because the formula used by the government to set realization prices for crude oil and oil products included adjustments based on exchange rate variations. See Item 4. Information on the Company Regulation of the Oil and Gas Industry in Brazil Price Regulation.

Since January 2, 2002, when prices were deregulated, we have been free to establish prices for our products based on market conditions and have generally been able to maintain parity with international prices. As a result, although substantially all of our revenues are in *reais*, they have been, and continue to be, linked to U.S. dollar-based international prices. When the *real* depreciates against the U.S. dollar, assuming international prices remain constant in U.S. dollars, we may increase the prices for our products in *reais*, in which case our net operating revenues in *reais* increase. An increase in our *reais* net operating revenue, however, is not reflected in our net operating revenue when reported in U.S. dollars, when the real depreciates.

Another effect of depreciation is that our operating costs and expenses when expressed in U.S. dollars tend to decline. This happens primarily due to the fact that a substantial portion of our costs and operating expenses is denominated in *reais*. Prior to 2003, our *reais*-denominated costs increased at a rate slower than the depreciation. Accordingly, the effect was to decrease costs of locally supplied products and services when reported in U.S. dollars.

The opposite effects occur when the real appreciates against the US dollar such as in 2004 and 2005.

In recent periods, the exchange rate variation has had the following additional effects, among others, on our financial condition and results of operations:

- We record the remeasurement effects of our non-*reais* denominated assets and liabilities held in Brazil (e.g., cash, cash equivalents and financial obligations) in our statements of income. Primarily because of our substantial liabilities denominated in foreign currency, we recorded a U.S.$269 million net foreign exchange gain in our 2005 statement of income, compared to a U.S.$368 million net foreign exchange gain in 2004 and a U.S.$2,433 million net foreign exchange loss in 2003. To the extent these variations are not recognized in a transaction (such as the repayment of the debt in the period in which there is a depreciation), the foreign exchange gain is added back for purposes of determining our cash flow;

- Our other assets and liabilities in Brazil, primarily accounts receivable, inventories and property, plant and equipment, cash and cash equivalents and government securities, pension plan liabilities, health care benefits and deferred income taxes, are all translated into U.S. dollars. Therefore, any depreciation (appreciation) of the *real* against the U.S. dollar will be reflected as a reduction (gain) in the U.S. dollar value of those assets and liabilities, charged directly to shareholders equity. These currency translation effects are beyond our control. Accordingly, we recorded a U.S.$3,107 million credit directly to shareholders equity in our statement of changes in shareholders equity for 2005, without affecting net income, to reflect the appreciation of the *real* against the U.S. dollar of approximately 11.8%, as compared to a credit of U.S.$1,911 million in 2004 to reflect the appreciation of 8.1% and a charge of U.S.$2,856 million in 2003 to reflect the depreciation of 18.2%.

Foreign currency translation adjustments reflecting a depreciation have the greatest impact on the balance sheet of a company such as ours, whose assets are primarily denominated in *reais*, but whose liabilities are primarily denominated in foreign currencies. The reductions in our asset values charged to shareholders equity, however, do not necessarily affect our cash flows, since our revenues and cash earnings are to a large degree linked to the U.S. dollar, and a portion of our operating expenses are linked to the *real*.

The exchange rate variation also impacts the amount of retained earnings available for distribution by us when measured in U.S. dollars. Amounts reported as available for distribution in our statutory accounting records prepared

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in accordance with Brazilian accounting principles decrease or increase when measured in U.S. dollars as the *real* depreciates or appreciates against the U.S. dollar. In addition, the exchange rate variation creates foreign exchange gains and losses that are included in our results of operations determined in accordance with Brazilian accounting principles and that affect the amount of our unretained earnings available for distribution.

Results of Operations

The differences in our operating results from year to year occur as a result of a combination of factors, including primarily: the volume of crude oil, oil products and natural gas we produce and sell, the price at which we sell our crude oil, oil products and natural gas and the differential between the Brazilian inflation rate and the depreciation or appreciation of the *real* against the U.S. dollar. The table below shows the amount by which each of these variables has changed during the last three years:

	2005	**2004**	**2003**
Crude Oil and NGL Production (Mbpd)			
Brazil	1,684	1,493	1,540
International	163	168	161
Total Crude Oil and NGL Production	1,847	1,661	1,701
Change in Crude Oil and NGL Production	11.2%	(2.4)%	10.8%
Average Sales Price for Crude (bpd in U.S.$)			
Brazil	$45.42	$33.49	$27.01
International	$34.91	$26.51	$ 23.7
Natural Gas Production (Mmcfpd)			
Brazil	1,644	1,590	1,500
International	576	564	510
Total Natural Gas Production	2,220	2,154	2,010
Change in Natural Gas Production (sold only)	3.1%	7.2%	21.8%
Average Sales Price for Natural Gas (Mcf in U.S.$)			
Brazil	2.17	1.93	1.79
International	1.64	1.17	1.26
Year End Exchange Rate	2.34	2.65	2.89
Appreciation (Depreciation) during the year	11.8%	8.1%	18.2%
Inflation Rate (IGP-DI)	1.2%	12.1%	7.7%

Results of Operations for the year ended December 31, 2005(2005) compared to the year ended December 31, 2004 (2004).

The comparison between our results of operations for 2005 and 2004 has been affected by the 16.8% decrease in the average Real/U.S. dollar exchange rate for 2005 as compared to the average Real/U.S. dollar exchange rate for 2004. We refer to this change in the average exchange rate as the 16.8% increase in the value of the Real against the U.S. dollar in 2005, as compared to 2004.

The exchange variation resulting from monetary assets and liabilities related to operations of consolidated subsidiaries whose functional currency is not Reais are not eliminated in the consolidation process and such results are accounted for as cumulative translation adjustments.

Certain prior year amounts have been reclassified to conform to current year presentation standards. These reclassifications had no impact on the Company s net income.

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Revenues

Net operating revenues increased 46.6% to U.S.$56,324 million for 2005, as compared to U.S.$38,428 million for 2004. This increase was primarily attributable to an increase in prices of our products, both in the domestic market and outside Brazil, an increase in sales volume in the domestic market, and the 16.8% increase in the value of the Real against the U.S. dollar in 2005, as compared to 2004.

Consolidated sales of products and services increased 42.6% to U.S.$74,065 million for 2005, as compared to U.S.$51,954 million for 2004, primarily due to the increases mentioned immediately above.

Included in sales of products and services are the following amounts that we collected on behalf of the federal or state governments:

Value-added (ICMS), PASEP, COFINS and other taxes on sales of products and services and social security contributions. These taxes increased 34.7% to U.S.$14,694 million for 2005, as compared to U.S.$10,906 million for 2004, primarily due to the increase in prices and sales volume of our products and services; and

CIDE, the per-transaction tax due to the Brazilian government, which increased 16.3% to U.S.$3,047 million for 2005, as compared to U.S.$2,620 million for 2004. This increase was primarily attributable to the increase in sales volume of our products and services and to the 16.8% increase in the value of the Real against the U.S. dollar in 2005, as compared to 2004.

Cost of sales (excluding Depreciation, Depletion and Amortization)

Cost of sales for 2005 increased 40.2% to U.S.$29,828 million, as compared to U.S.$21,279 million for 2004. This increase was principally a result of:

a U.S.$1,834 million increase in taxes and charges paid to the Brazilian government totaling U.S.$5,410 million for 2005, as compared to U.S.$3,576 million for 2004, including an increase in the special participation charge (an extraordinary charge payable in the event of high production and/or profitability from our fields) to U.S.$3,016 million for 2005, as compared to U.S.$1,883 million for 2004, as a result of higher international oil prices;

a U.S.$1,654 million increase in the cost of imports due to higher prices for the products imported;

a U.S.$1,375 million increase in costs attributable to: (1) maintenance and technical services for well restoration, materials, support for vessels, undersea operations, freight with third parties (these prices tend to accompany to international oil prices) consumption of chemical products to clear out and eliminate toxic gases principally at Marlim; and (2) higher personnel expenses primarily related to: overtime payments as set forth in our collective bargaining agreement; an increase in our workforce; and a revision in the actuarial calculations relating to future health care and pension benefits;

a U.S.$1,281 million increase in costs associated with our international trading activities, due to increases in volume and prices from offshore operations, conducted by PIFCo;

a U.S.$561 million increase in costs associated with a 9.0% increase in our international market sales volumes;

a U.S.$534 million increase in costs in our Argentinean subsidiary PEPSA mainly due to oil products purchases as a result of total capacity utilization of its refineries and higher sales volume of petrochemical products;

a U.S.$198 million increase in costs associated with a 1.7% increase in our domestic sales volumes; and

the 16.8% increase in the value of the Real against the U.S. dollar in 2005, as compared to 2004.

Depreciation, depletion and amortization

We calculate depreciation, depletion and amortization of exploration and production assets on the basis of the units of production method. Depreciation, depletion and amortization expenses increased 17.9% to U.S.$2,926 million for 2005, as compared to U.S.$2,481 million for 2004. This increase was primarily attributable to the following:

increased property, plant and equipment expenditures, and increased crude oil and natural gas production; and

the 16.8% increase in the value of the Real against the U.S. dollar in 2005, as compared to 2004.

Exploration, including exploratory dry holes

Exploration costs, including exploratory dry holes increased 64.6% to U.S.$1,009 million for 2005, as compared to U.S.$613 million for 2004. We adopted the amended FAS 19-1 effective January 1, 2005, without material impact. This increase was primarily attributable to the following:

the increase of U.S.$196 million due to a revision in the estimated expenses for dismantling oil and gas producing areas and future well abandonment that affected the exploration costs and was related to new commercial areas, increased estimates of cost to abandon and changes in asset retirement obligations estimates provided by operators in joint ventures;

an increase of U.S.$98 million in geological and geophysical expenses;

an increase of U.S.$16 million in dry holes expenses; and

the 16.8% increase in the value of the Real against the U.S. dollar in 2005, as compared to 2004.

Impairment of oil and gas properties

For 2005, we recorded an impairment charge of U.S.$156 million, as compared to an impairment charge of U.S.$65 million for 2004. During 2005, the impairment charge was primarily related to investments in Venezuela (U.S.$134 million), due to the tax and legal changes implemented by the Ministry of Energy and Petroleum of Venezuela (MEP). During 2004, the impairment charge was related to producing properties in Brazil and principle amounts were related to the Company s Cioba off-shore field (U.S.$30 million). See Note 10 (d) to our consolidated financial statements for the year ended December 31, 2005.

Selling, general and administrative expenses

Selling, general and administrative expenses increased 54.2% to U.S.$4,474 million for 2005, as compared to U.S.$2,901 million for 2004.

Selling expenses increased 38.7% to U.S.$2,141 million for 2005, as compared to U.S.$1,544 million for 2004. This increase was primarily attributable to the following:

an increase of U.S.$338 million in expenses mainly associated with the transportation costs of oil products due mainly to an increase in the exports; and

the 16.8% increase in the value of the Real against the U.S. dollar in 2005, as compared to 2004.

General and administrative expenses increased 71.9% to U.S.$2,333 million for 2005, as compared to U.S.$1,357 million for 2004. This increase was primarily attributable to the following:

an increase of approximately U.S.$287 million in employee expenses due to the increase in our workforce and salaries; and an increase in the actuarial calculations relating to future health care and pension benefits due to changes in actuarial assumptions;

an increase of approximately U.S.$212 million in expenses related to technical consulting services in connection with our increased outsourcing of selected non-core general activities; and

the 16.8% increase in the average value of the Real against the U.S. dollar in 2005, as compared to 2004.

Research and development expenses

Research and development expenses increased 60.9% to U.S.$399 million for 2005, as compared to U.S.$248 million for 2004. This increase was primarily related to additional investments in programs for environmental safety, to deepwater and refining technologies of approximately U.S.$101 million and to the 16.8% increase in the value of the Real against the U.S. dollar in 2005, as compared to 2004.

Other operating expenses

Other operating expenses amounted to U.S.$582 million for 2005, as compared to U.S.$259 million for 2004.

The charges for 2005 were:

a U.S.$304 million expense for idle capacity from gas-fired power plants;

a U.S.$153 million loss related to our investments in certain gas-fired power plants resulting from our contractual obligations to cover losses;

a U.S.$64 million expense for unscheduled stoppages of plants and equipment; and

a U.S.$61 million increase in contractual losses from compliance with our ship or pay commitments with respect to our investments in the OCP pipeline in Ecuador.

The charges for 2004 were:

a U.S.$110 million expense for idle capacity from gas-fired power plants;

a U.S.$85 million expense for unscheduled stoppages of plant and equipment; and

a U.S.$64 million increase in contractual losses from compliance with our ship or pay commitments with respect to our investments in the OCP pipeline in Ecuador.

Equity in results of non-consolidated companies

Equity in results of non-consolidated companies decreased 19.2% to a gain of U.S.$139 million for 2005, as compared to a gain of U.S.$172 million for 2004, primarily due to the results of our investments in:(a) certain gas-fired power and petrochemical companies being lower as certain of these entities have been subsequently purchased and are now consolidated on a line by line basis; and (b) as a result of losses in investments in certain affiliated companies of Petrobras Energia Venezuela S.A, in the amount of U.S.$19 million.

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Financial income

We derive financial income from several sources, including interest on cash and cash equivalents. The majority of our cash equivalents are short-term Brazilian government securities, including securities indexed to the U.S. dollar. We also hold U.S. dollar deposits.

Financial income decreased 25.7% to U.S.$710 million for 2005 as compared to U.S.$ 956 million for 2004. This decrease was primarily attributable to the reduction of fair value adjustments on gas hedge transactions in the amount of U.S.$460 million.

This decrease was partially offset by an increase in financial interest income from short-term investments, in the amount of U.S.$138 million, primarily attributable to increased investments in securities in 2005 as compared to 2004, due to higher amount of cash and cash equivalents. A breakdown of financial income and expenses is shown in Note 14 to our consolidated financial statements for the year ended December 31, 2005.

Financial expenses

Financial expenses decreased 31.4% to U.S.$1,189 million for 2005, as compared to U.S.$1,733 million for 2004. This decrease was primarily attributable to:

- a U.S.$345 million increase in our interest expense capitalized as part of the cost of construction and development of crude oil and natural gas production projects. A breakdown of financial income and expenses is shown in Note 14 to our consolidated financial statements for the year ended December 31, 2005;
- a U.S.$130 million decrease of expenses related to hedge transactions; and
- a U.S.$120 million decrease in expenses relating to repurchases of our own securities.

Monetary and exchange variation on monetary assets and liabilities, net

Monetary and exchange variation on monetary assets and liabilities, net generated a gain of U.S.$248 million for 2005, as compared to a gain of U.S.$450 million for 2004. The decrease in monetary and exchange variation on monetary assets and liabilities, net is primarily attributable to the effect of the 11.8% year ended value appreciation of the Real against the U.S. dollar during 2005, as compared to the 8.1% appreciation of the Real against the U.S. dollar during 2004.

Employee benefit expense for non-active participants

The employee benefit expense consists of financial costs associated with expected pension and health care costs. Our employee benefit expense increased 52.9% to U.S.$ 994 million for 2005, as compared to U.S.$650 million for 2004. This increase in costs was primarily attributable to an increase of U.S.$212 million in the annual actuarial calculation of our pension and health care plan liability and to the 16.8% average increase in the value of the Real against the U.S. dollar in 2005, as compared to 2004.

Other taxes

Other taxes, consisting of miscellaneous value-added, transaction and sales taxes, decreased 15.2% to U.S.$373 million for 2005, as compared to U.S.$440 million for 2004. This decrease was primarily attributable to the decrease of U.S.$149 million in the PASEP/COFINS taxes on financial income, due to a reduction to zero in the applicable rate as of August 2, 2004. This decrease was partially offset by the 16.8% increase in the value of the Real against the U.S. dollar in 2005, as compared to 2004.

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Other expenses, net

Other expenses, net are primarily composed of gains and losses recorded on sales of investments, institutional relations and cultural project expenses and certain other non-recurring charges. Other expenses, net increased 123.6% to U.S.$899 million for 2005, as compared to U.S.$402 million for 2004.

The most significant charges for 2005 were:

- a U.S.$397 million expense for institutional relations and cultural projects;
- a U.S.$255 million loss related to the exchange of assets between us and Repsol that occurred in 2001. See Note 11(c) to our consolidated financial statements for the year ended December 31, 2005; and
- a U.S.$139 million expense for legal liability and contingencies related to pending lawsuits.

The most significant charges for 2004 were:

- a U.S.$262 million expense for institutional relations and cultural projects;
- an U.S.$87 million expense for legal liability and contingencies related to pending lawsuits. See Note 21 to our consolidated financial statements for the year ended December 31, 2005; and
- a U.S.$46 million provision for tax assessments received from the Instituto Nacional de Seguridade Social (National Social Security Institute, or INSS). See Note 21 to our consolidated financial statements for the year ended December 31, 2005.

Income tax (expense) benefit

Income before income taxes, minority interest, extraordinary item and accounting changes increased 63.3% to U.S.$14,592 million for 2005, as compared to U.S.$8,935 million for 2004. The income tax expense increased 99.1% to U.S.$4,441 million for 2005, as compared to U.S.$2,231 million for 2004, primarily due to the increase in income, mentioned above. This increase was partially offset by the additional tax benefits related to interest on shareholders equity that amounted to U.S.$791million for 2005, as compared to U.S.$650 million for 2004.

The reconciliation between the tax calculated based upon statutory tax rates to income tax expense and effective rates is shown in Note 4 to our consolidated financial statements for the year ended December 31, 2005.

Extraordinary gain, net of taxes

We recorded an extraordinary gain, net of taxes, in the amount of U.S.$158 million due to the Escalators Liquidation Agreement entered into on December 29, 2005, and effective as from January 1, 2006, related to a contingent purchase price adjustment on the exchange of assets between us and Repsol that occurred in 2001. See Note 11(c) to our consolidated financial statements for the year ended December 31, 2005.

Results of Operations for the year ended December 31, 2004 (2004) compared to the year ended December 31, 2003 (2003).

The comparison between our results of operations for 2004 and 2003 has been affected by the 4.8% decrease in the average Real/U.S. dollar exchange rate for 2004 as compared to the average Real/U.S. dollar exchange rate for 2003. For ease, we refer to this change in the average exchange rate as the 4.8% increase in the value of the Real against the U.S. dollar in 2004, as compared to 2003.

Certain amounts from prior years have been reclassified to conform to current year presentation standards. These reclassifications had no impact on the Company s net income.

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Revenues

Net operating revenues increased 24.3% to U.S.$38,428 million for 2004, as compared to U.S.$30,914 million for 2003. This increase was primarily attributable to an increase in prices of our products, both in the domestic market and outside Brazil, an increase in sales volume in the domestic market, and the 4.8% increase in the value of the Real against the U.S. dollar in 2004, as compared to 2003.

Consolidated sales of products and services increased 21.7% to U.S.$51,954 million for 2004, as compared to U.S.$42,690 million for 2003, primarily due to the increases mentioned immediately above.

Included in sales of products and services are the following amounts that we collected on behalf of the federal or state governments:

- Value-added (ICMS) and other taxes on sales of products and services and social security contributions. These taxes increased 14.5% to U.S.$10,906 million for 2004, as compared to U.S.$9,527 million for 2003, primarily due to the increase in prices and sales volume of our products and services; and

- CIDE, the per-transaction tax due to the Brazilian government, which increased 16.5% to U.S.$2,620 million for 2004, as compared to U.S.$2,249 million for 2003. This increase was primarily attributable to the increase in sales volume of our products and services and to the 4.8% increase in the value of the Real against the U.S. dollar in 2004, as compared to 2003.

Cost of sales

Cost of sales for 2004 increased 37.0% to U.S.$21,279 million, as compared to U.S.$15,533 million for 2003. This increase was principally a result of:

- a U.S.$2,037 million increase in the cost of imports due to higher prices and a greater volume of imports;

- a U.S.$775 million increase in costs associated with a 6.6% increase in our domestic sales volumes;

- a U.S.$644 million increase in costs of certain gas-fired power plants, whose financial statements we have been consolidating line by line since January 1, 2004, as a result of the adoption of FIN 46;

- a U.S.$556 million increase in costs associated with our international trading activities, due to increases in volume and prices from offshore operations, conducted by PIFCo;

- a U.S.$495 million increase in taxes and charges paid to the Brazilian government totaling U.S.$3,576 million for 2004, as compared to U.S.$3,081 million for 2003, including an increase in the special participation charge (an extraordinary charge payable in the event of high production and/or profitability from our fields) to U.S.$1,883 million for 2004, as compared to U.S.$1,625 million for 2003, as a result of higher international oil prices;

- a U.S.$354 million increase in costs associated with the full consolidation of PEPSA and PELSA; and

- the 4.8% increase in the value of the Real against the U.S. dollar in 2004, as compared to 2003.

Depreciation, depletion and amortization

We calculate depreciation, depletion and amortization of exploration and production assets on the basis of the units of production method. Depreciation, depletion and amortization expenses increased 39.0% to U.S.$2,481 million for 2004, as compared to U.S.$1,785 million for 2003. This increase was primarily attributable to the following:

- an increase of approximately U.S.$331 million resulting from higher depreciation principally associated with the Dourado, Roncador, Marlim Sul and Jubarte Fields as a result of increased property, plant and equipment (PP&E) expenditures;

an increase of approximately U.S.$156 million resulting from the full consolidation of PEPSA and PELSA; and

the 4.8% increase in the value of the Real against the U.S. dollar in 2004, as compared to 2003.

Exploration, including exploratory dry holes

Exploration costs, including exploratory dry holes increased 19.7% to U.S.$613 million for 2004, as compared to U.S.$512 million for 2003. This increase was primarily attributable to the following:

an increase of U.S.$165 million in dry holes expenses, including U.S.$72 million associated with the write-off of signature bonuses in Angola;

an increase of U.S.$56 million in geological and geophysical expenses;

an increase of approximately U.S.$29 million resulting from the full consolidation of PEPSA and PELSA; and

the 4.8% increase in the value of the Real against the U.S. dollar in 2004, as compared to 2003.

These increases were partially offset by a decrease of U.S.$196 million due to a revision in the estimated expenses for dismantling oil and gas producing areas and future well abandonment.

Impairment of oil and gas properties

For 2004, we recorded an impairment charge of U.S.$65 million, as compared to an impairment charge of U.S.$70 million for 2003. The impairment charge in 2004 related to capital expenditures for Brazilian fields in production, but with only marginal reserves. We also recorded an impairment charge of U.S.$13 million due to goodwill assessment. In 2003, the impairment charge was related to certain of our oil and gas producing properties in Brazil, Colombia and Angola. These charges were recorded based upon our annual assessment of these fields using prices consistent with those used in our overall Strategic Plan and discounted at a rate of 10%, a rate consistent with the rate used for internal project valuations.

Selling, general and administrative expenses

Selling, general and administrative expenses increased 38.7 % to U.S.$2,901 million for 2004, as compared to U.S.$2,091 million for 2003.

Selling expenses increased 51.4% to U.S.$1,544 million for 2004, as compared to U.S.$1,020 million for 2003. This increase was primarily attributable to the following:

an increase of U.S.$368 million in expenses mainly associated with the transportation costs of oil products. A portion of these expenses were previously classified as cost of sales in 2003;

an increase of approximately U.S.$33 million in selling expenses resulting from the full consolidation of PEPSA and PELSA;

an increase of approximately U.S.$33 million in selling expenses resulting from the charge for doubtful accounts; and

the 4.8% increase in the value of the Real against the U.S. dollar in 2004, as compared to 2003.

General and administrative expenses increased 26.7% to U.S.$1,357 million for 2004, as compared to U.S.$1,071 million for 2003. This increase was primarily attributable to the following:

the 4.8% increase in the value of the Real against the U.S. dollar in 2004, as compared to 2003;

an increase of approximately U.S.$110 million in expenses related to technical consulting services in connection with our increased outsourcing of selected non-core general activities;

- an increase of approximately U.S.$45 million resulting from the full consolidation of PEPSA and PELSA; and

- an increase of approximately U.S.$72 million in employee expenses due to the increase in our workforce and salaries; and an increase in the actuarial calculations relating to future health care and pension benefits.

Research and development expenses

Research and development expenses increased 23.4% to U.S.$248 million for 2004, as compared to U.S.$201 million for 2003. This increase was primarily related to additional investments in programs for environmental safety, deepwater and refining technologies of approximately U.S.$36 million and to the 4.8% increase in the value of the Real against the U.S. dollar in 2004, as compared to 2003.

Other operating expenses

Other operating expenses decreased 20.6% to an expense of U.S.$259 million for 2004, as compared to an expense of U.S.$326 million for 2003.

The charges for 2004 were:

- a U.S.$110 million expense for idle capacity from gas-fired power plants;

- a U.S.$85 million expense for unscheduled stoppages of plant and equipment; and

- a U.S.$64 million increase in contractual losses from compliance with our ship or pay commitments with respect to our investments in the OCP pipeline in Ecuador.

The charges for 2003 were:

- a U.S.$173 million expense for unscheduled stoppages of plant and equipment;

- a U.S.$97 million provision for expected losses on the sale of property, plant and equipment related to offshore production; and

- a U.S.$56 million increase in losses associated with our ship or pay commitments related to the OCP pipeline in Ecuador.

Equity in results of non-consolidated companies

Equity in results of non-consolidated companies increased 22.0% to a gain of U.S.$172 million for 2004, as compared to a gain of U.S.$141 million for 2003, due primarily to a U.S.$21 million gain as a result of the consolidation of PEPSA and PELSA and their equity method investees for the full year in 2004, as opposed to approximately seven months in 2003.

Financial income

We derive financial income from several sources, including interest on cash and cash equivalents. The majority of our cash equivalents are short-term Brazilian government securities, including securities indexed to the U.S. dollar. We also hold U.S. dollar deposits.

Financial income increased 50.8% to U.S.$956 million for 2004 as compared to U.S.$634 million for 2003. This increase was primarily attributable to fair value adjustments on gas hedge transactions, which was partially offset by a decrease in financial interest income from short-term investments due to higher investments in securities indexed to the U.S. dollar in 2004 when compared to 2003, resulting in lower income due to the effect of the 8.1% appreciation of the Real against the U.S. dollar during 2004, as compared to the 18.2% year ended value appreciation of the Real against the U.S. dollar during 2003. A breakdown of financial income and expenses is shown in Note 14 to our audited consolidated financial statements for the year ended December 31, 2004.

Financial expense

Financial expense increased 39.0% to U.S.$1,733 million for 2004, as compared to U.S.$1,247 million for 2003. This increase was primarily attributable to an increase of approximately U.S.$233 million in financial expenses resulting from PEPSA s hedge operations; as well as a loss of U.S.$137 million on repurchases of our own securities.

Monetary and exchange variation on monetary assets and liabilities, net

Monetary and exchange variation on monetary assets and liabilities, net generated a gain of U.S.$450 million for 2004, as compared to a gain of U.S.$509 million for 2003. The decrease in monetary and exchange variation on monetary assets and liabilities, net is primarily attributable to the effect of the 8.1% appreciation of the Real against the U.S. dollar during 2004, as compared to the 18.2% year ended value appreciation of the Real against the U.S. dollar during 2003.

Employee benefit expense

Employee benefit expense consists of financial costs associated with expected pension and health care costs. Our employee benefit expense increased 9.2% to U.S.$650 million for 2004, as compared to U.S.$595 million for 2003. This increase in costs was primarily attributable to an increase of U.S.$25 million from the annual actuarial calculation of our pension and health care plan liability and to the 4.8% increase in the value of the Real against the U.S. dollar in 2004, as compared to 2003.

Other taxes

Other taxes, consisting of miscellaneous value-added, transaction and sales taxes, increased 32.1% to U.S.$440 million for 2004, as compared to U.S.$333 million for 2003. This increase was primarily attributable to the following:

- an increase of U.S.$37 million in the CPMF, a tax payable in connection with certain financial transactions;
- an increase of U.S.$22 million in taxes related to our international activities;
- an increase of U.S.$18 million in the PASEP/COFINS taxes on financial income, due to an increase in the COFINS tax rate from 3.0% to 7.6% beginning February 1, 2004; and
- the 4.8% increase in the value of the Real against the U.S. dollar in 2004, as compared to 2003.

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Other expenses, net

Other expenses, net are primarily composed of gains and losses recorded on sales of fixed assets, general advertising and marketing expenses and certain other non-recurring charges. Other expenses, net decreased to an expense of U.S.$402 million for 2004, as compared to an expense of U.S.$732 million for 2003.

The most significant charges for 2004 were:

- a U.S.$262 million expense for institutional relations and cultural projects;
- a U.S.$87 million expense for legal liability and contingencies related to pending lawsuits; and
- a U.S.$46 million provision for tax assessments received from the Instituto Nacional de Seguridade Social (National Social Security Institute, or INSS). See Item 8. Financial Information Legal Proceedings and Note 21 to our audited consolidated financial statements for the year ended December 31, 2004.

The most significant charges for 2003 were:

- a U.S.$198 million expense for institutional relations and cultural projects;
- a U.S.$183 million loss related to our investments in certain gas-fired power plants resulting from our contractual obligations to cover losses when decreased demand for power and electricity resulted in lower prices;
- a U.S.$130 million expense for legal liability and contingencies related to pending lawsuits. See Note 21 to our audited consolidated financial statements for the year ended December 31, 2004;
- a U.S.$114 million expense for a lower of cost or market adjustment with respect to turbines we expected to use in connection with our gas-fired power projects, but which we did not use for such projects; and
- a U.S.$55 million provision for tax assessments received from the INSS.

Income tax (expense) benefit

Income before income taxes, minority interest and accounting changes increased 1.8% to U.S.$8,935 million for 2004, as compared to U.S.$8,773 million for 2003. The income tax expense decreased 16.2% to U.S.$2,231 million for 2004, as compared to an expense of U.S.$2,663 million for 2003, primarily due to the additional tax benefits related to interest on shareholders equity that amounted to U.S.$650 million for 2004, as compared to U.S.$364 million for 2003.

The reconciliation between the tax calculated based upon statutory tax rates to income tax expense and effective rates is shown in Note 4 to our audited consolidated financial statements for the year ended December 31, 2004.

Cumulative effect of change in accounting principle

As of January 1, 2003, we generated a gain of U.S.$697 million (net of U.S.$359 million of taxes) resulting from the adoption of SFAS No. 143 Accounting for Asset Retirement Obligations. The adjustment was due to the difference in the method of accruing end of life asset retirement obligations under SFAS 143, as compared with the method required by SFAS 19 Financial Accounting and Reporting by Oil and Gas Producing Companies.

Business Segments

Set forth below is selected financial data by segment for 2005, 2004 and 2003:

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SELECTED FINANCIAL DATA BY SEGMENT

	For the Year Ended December 31,		
	2005	2004	2003
	(In millions of U.S. dollars)		
Exploration, Development and Production (Exploration and Production Segment)			
Net revenues to third parties (1)(3)	$ 1,874	$ 2,487	$ 2,369
Intersegment net revenues	26,950	16,384	13,329
Total net operating revenues (3)	28,824	18,871	15,698
Depreciation, depletion and amortization	(1,571)	(1,322)	(955)
Net income	9,542	5,961	5,504
Capital expenditures	6,127	4,574	3,658
Property, plant and equipment, net	25,869	20,458	16,742
Refining, Transportation and Marketing (Supply Segment)			
Net revenues to third parties (1)(2)(3)	$ 33,229	$ 20,981	$ 17,405
Intersegment net revenues	12,286	7,786	6,585
Total net operating revenues (2)(3)	45,515	28,767	23,990
Depreciation, depletion and amortization	(644)	(548)	(397)
Net income (2)	2,422	854	1,743
Capital expenditures	1,749	1,367	1,451
Property, plant and equipment, net	8,085	6,333	4,980
Distribution (Distribution Segment)			
Net revenues to third parties (1)	$ 15,642	$ 10,328	$ 7,876
Intersegment net revenues	225	159	138
Total net operating revenues	15,867	10,487	8,014
Depreciation, depletion and amortization	(100)	(59)	(29)
Net income	318	200	138
Capital expenditures	207	47	106
Property, plant and equipment, net	1,236	1,011	442
Natural Gas and Power (Gas and Energy Segment)			
Net revenues to third parties (1)	$ 1,932	$ 1,547	$ 1,234
Intersegment net revenues	1,232	474	245
Total net operating revenues	3,164	2,021	1,479
Depreciation, depletion and amortization	(105)	(100)	(87)
Net income (loss)	(473)	154	(196)
Capital expenditures	694	782	694
Property, plant and equipment, net	5,326	4,506	4,174
International (International Segment)			
Net revenues to third parties (1) (2)	$ 3,647	$ 3,085	$ 2,030
Intersegment net revenues	881	519	129
Total net operating revenues (2)	4,528	3,604	2,159
Depreciation, depletion and amortization	(461)	(423)	(288)
Net income (2)	308	243	96

Capital expenditures	1,175	727	480
Property, plant and equipment, net	4,655	4,160	4,181

(1) As a vertically integrated company, not all of our segments have significant third-party revenues. For example, our exploration and production segment accounts for a large part of our economic activity and capital expenditures, but has little third party revenues.

(2) Net operating revenues and the cost of sales with respect to 2003 were reclassified from the International segment to the Supply segment in relation to certain offshore operations. There was no significant impact on the results reported for these segments.

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(3) In 2005, revenues from commercialization of oil to third parties are being classified in accordance with the points of sale, which could be either the Exploration & Production or Supply segments. Until 2004, revenues from commercialization of oil were allocated entirely to the Exploration & Production segment. This classification generated no significant impact on the results reported for these segments and segment information has not been restated as it is impracticable to gather and collect data for prior periods as to point of sale.

Management s Discussion and Analysis of PIFCo s Financial Condition and Results of Operations

You should read the following discussion of PIFCo s financial condition and results of operations together with PIFCo s attached audited consolidated financial statements and the accompanying notes beginning on page F-148. PIFCo s audited consolidated financial statements and the accompanying notes have been presented in U.S. dollars and prepared in accordance with U.S. GAAP. In addition, as our subsidiary, PIFCo also prepares financial statements in accordance with accounting practices adopted in Brazil.

Overview

PIFCo is our wholly-owned subsidiary. Accordingly, PIFCo s financial position and results of operations are significantly affected by our decisions, as its parent company. PIFCo s ability to meet its outstanding debt obligations depends on a number of factors, including:

- our financial condition and results of operations;
- the extent to which we continue to use PIFCo s services for market purchases of crude oil and oil products;
- our willingness to continue to make loans to PIFCo and provide PIFCo with other types of financial support;
- PIFCo s ability to access financing sources, including the international capital markets and third-party credit facilities; and
- PIFCo s ability to transfer its financing costs to us.

PIFCo earns income from:

- sales of crude oil and oil products to us;
- limited sales of crude oil and oil products to affiliates and third parties; and
- financial income derived from financing of sales to us, inter-company loans to us and investments in marketable securities and other financial instruments.

PIFCo s operating expenses include:

- cost of sales, which is comprised mainly of purchases of crude oil and oil products;
- selling, general and administrative expenses; and
- financial expense, mainly from interest on its lines of credit and capital markets indebtedness, sales of future receivables and inter-company loans from us.

Purchases and Sales of Crude Oil and Oil Products

PIFCo typically purchases crude oil and oil products in transactions with payment terms of approximately 30 days. We typically pay for shipments of crude oil and oil products that PIFCo sells over a period of up to 330 days, which allows us sufficient time to assemble the necessary documentation under Brazilian law to commence the payment process for such shipments. Before February 2005, PIFCo sold crude oil and oil products to us under terms that allowed for payment up to 270 days from the date of the bill of lading. During this period, PIFCo typically finances the purchase of crude oil and oil products through either funds previously provided by us or third-party

trade finance arrangements. The difference between the amount PIFCo pays for crude oil and oil products and the amount we pay for that same crude oil and oil products is deferred and recognized as part of PIFCo s financial income on a straight-line basis over the period in which our payments to PIFCo come due.

Results of Operations

Results of operations for the year ended December 31, 2005 compared to the year ended December 31, 2004.

Net Loss

PIFCo had a net loss of U.S.$27.8 million in 2005, as compared to a net loss of U.S.$59.1 million in 2004.

Sales of Crude Oil and Oil Products and Services

PIFCo s sales of crude oil and oil products and services increased 38.7% from U.S.$12,355.6 million in 2004 to U.S.$17,136.1 million in 2005. This increase was primarily due to (1) a 42% increase in the average price of Brent crude oil, from U.S.$38.21 per barrel during 2004 to U.S.$ 54.38 per barrel in 2005, (2) a 73.1% increase in the volume of export sales of crude oil to related party PETROBRAS AMERICA INC PAI mainly due to the increase of our national production of crude oil and (3) a 22.0% increase in the volume of offshore sales of crude oil and oil products purchased from third parties and affiliates and sold to third parties and affiliates.

Cost of Sales

Cost of sales increased 38.8% from U.S.$12,236.0 million in 2004 to U.S.$16,983.3 million in 2005. This increase was primarily due to the increase in the average price of Brent crude oil and the increase in export and offshore sales, described above.

Selling, General and Administrative Expenses

PIFCo s selling, general and administrative expenses consist primarily of shipping costs and fees for services, including accounting, legal and rating services. These expenses increased 66.0% from U.S.$99.8 million in 2004 to U.S.$165.7 million in 2005, of which U.S.$159.6 million consisted of shipping expenses and, which increased, due to (1) the increased volume of offshore sales, (2) an average increase in freight costs in the period resulting from changes in international market trends and shipping routes and (3) U.S.$31.3 million refered to adjusted freight costs in offshore sales.

Financial Income

PIFCo s financial income consists of the financing of sales to us and inter-company loans to us, investments in marketable securities and other financial instruments. PIFCo s financial income increased 45.0% from U.S.$678.8 million in 2004 to U.S.$984.0 million in 2005, primarily due to (1) an increase in interest income from short and long-term investments as a result of an increase in the average of balance of the investments during 2005 compared to 2004 and higher interest rates; (2) an increase in the amount of sales to us made during 2004 compared to 2003, as well as the amount of sales during 2005, resulting in additional financial income due to the financing terms granted to us and recognized as interest on a monthly basis (see Purchases and Sales of Crude Oil and Oil Products); and (3) extended financing terms beyond the established payment period for sales to us.

Financial Expense

PIFCo s financial expense consists of interest paid and accrued on its outstanding indebtedness and other fees associated with its issuance of debt. PIFCo s financial expense increased 31.2% from U.S.$761.2 million in 2004 to U.S.$998.9 million in 2005, primarily due to an increase in inter-company loans from us and due to interest expenses associated with PIFCo s issuance of U.S.$600.0 million Global Notes in September 2004.

Results of operations for the year ended December 31, 2004 (2004) compared to the year ended December 31, 2003 (2003).

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Net Loss

PIFCo had a net loss of U.S.$59.1 million in 2004, as compared to a net loss of U.S.$3.0 million in 2003.

Sales of Crude Oil and Oil Products and Services

PIFCo s sales of crude oil and oil products and services increased 77.1% from U.S.$6,975.5 million in 2003 to U.S.$12,355.6 million in 2004. This increase was primarily due to (1) a 27.1 % increase in the volume of sales of crude oil and oil products to us, (2) an increase in exports of crude oil and oil products, principally to PETROBRAS AMERICA INC. PAI (PAI), as a result of PIFCo s new role as an intermediary for our exports that PIFCo assumed from another affiliate of ours beginning January 1, 2004, which increased sales volumes of crude oil and oil products by approximately 16.2% in 2004, (3) a 32.5% increase in the average price of Brent crude oil from U.S.$28.84 per barrel during 2003 to U.S.$38.21 per barrel during 2004 and (4) an increase in the volume of offshore sales of crude oil and oil products purchased from third parties and sold to third parties and affiliates.

Cost of Sales

Cost of sales increased 76.8% from U.S.$6,920.2 million in 2003 to U.S.$12,236.0 million in 2004. This increase was primarily due to a 27.1% increase in the volume of sales of crude oil and oil products to us, additional sales linked to PIFCo s new export activities, principally to PAI, a 32.5% increase in the average price of Brent crude oil from U.S.$28.84 per barrel during 2003 to U.S.$38.21 per barrel during 2004, as well as an increase in the volume of offshore sales of crude oil and oil products purchased from third parties and sold to third parties and affiliates.

Selling, General and Administrative Expenses

PIFCo s selling, general and administrative expenses consist primarily of shipping costs and fees for services, including accounting, legal and rating services. These expenses increased from U.S.$18.6 million in 2003 to U.S.$99.8 million in 2004, of which U.S.$96.8 million consisted of shipping expenses. In July 2003, our management decided to assign the responsibility for payment of shipping expenses previously paid by us, to PIFCo. PIFCo s expects shipping costs to figure permanently as part of its selling, general and administrative expenses.

Financial Income

PIFCo s financial income consists of the financing of sales to us, inter-company loans to us and investments in marketplace securities and other financial instruments. PIFCo s financial income increased 53.3% from U.S.$442.9 million in 2003 to U.S.$678.8 million in 2004, primarily due to an increase in the amount of sales to us, an increase in the interest component of the formula by which we reimburse PIFCo for its financing costs and for receipt of payments beyond the time periods previously agreed with us, and an increase in interest income from short-term investments.

Financial Expense

PIFCo s financial expense consists of interest paid and accrued on its outstanding indebtedness and other fees associated with its issuance of debt. PIFCo s financial expense increased 57.7% from U.S.$482.7 million in 2003 to U.S.$761.2 million in 2004, primarily due to a register of an expense in the amount of U.S.$64.2 million related to the difference between the face value and the market value of the repurchase of some of its outstanding securities.

Liquidity and Capital Resources

Petrobras

Overview

Our principal uses of funds are for capital expenditures, dividend payments and repayment of debt. We have historically met these requirements with internally generated funds, short-term debt, long-term debt, project financings and sale and lease back agreements. We believe these sources of funds, together with our strong cash and cash equivalents on hand, will continue to allow us to meet our currently anticipated capital requirements. In 2006,

our major cash needs include planned capital expenditures of U.S.$ 15,416 million, announced dividends of U.S.$3,068 million and payments of U.S.$4,080 million on our long-term debt, leasing and project financing obligations.

Financing Strategy

The objective of our financing strategy is to help us achieve the targets set forth in our Strategic Plan released on August 19, 2005, which provides for capital expenditures of U.S.$ 56.4 billion through 2010. We also aim to increase the average life of our debt portfolio and reduce our cost of capital through a variety of medium and long-term financing arrangements, including supplier financing, project financings, bank financing, securitizations and issuances of debt.

Government Regulation

The Ministry of Planning, Budget and Management controls the total amount of medium and long-term debt that we and our Brazilian subsidiaries are allowed to incur through the annual budget approval process (*Plano de Dispêndio Global*, or PDG). Before issuing medium and long-term debt, we and our Brazilian subsidiaries must also obtain the approval of the National Treasury shortly before issuance.

In accordance with Senate Resolution Nº 96/89 the level of our borrowings is subject to an annual maximum amount, exclusive of certain permitted commercial obligations, based on shareholders equity, debt service expense and other factors as of the prior year and subject to certain ongoing quarterly adjustments. For 2005, the maximum level of debt that Petrobras could incur was set at U.S.$891.6 million. The maximum level was set at U.S.$958 million for 2004 and U.S.$932 million for 2003.

All of our foreign currency denominated debt, as well as the foreign currency denominated debt of our Brazilian subsidiaries require registration with the Central Bank. The issuance of debt by our international subsidiaries, however, is not subject to registration with the Central Bank or approval by the National Treasury. In addition, all issuances of medium and long-term notes and debentures require the approval of our board of directors. Borrowings that exceed the approved budget amount for any year also require approval from the Brazilian Senate.

Sources of Funds

Cash Flow

At December 31, 2005, we had cash and cash equivalents of U.S.$ 9,871 million as compared to U.S.$6,856 million at December 31, 2004.

Operating activities provided net cash flows of U.S.$15,115 million in 2005, as compared to U.S.$8,155 million in 2004. Major effects to cash generated by operating activities were net operating revenues that increased U.S.$17,896 million, primarily due to an increase in sales volume in the domestic market, an increase in prices in both the domestic market and outside Brazil and an increase of exports of oil and oil products. The increase was mitigated by decreases in costs and expenses related to the purchase of crude.

Net cash used in investing activities increased to U.S.$10,207 million in 2005, as compared to U.S.$7,743 million in 2004. This increase was due primarily to our investments in capital expenditures associated with our operating activities, which used U.S.$10,365 million of cash including U.S.$6,127 million in relation to our exploration and production projects, principally in the Campos Basin.

Financing activities used net cash of U.S.$2,625 million in 2005, as compared to providing net cash in the amount of U.S.$2,204 million in 2004. Levels of financing activities for year ended December 31, 2005 and 2004 remained significantly unchanged. Dividends paid in the year ended December 31, 2005 were U.S.$2,110 million, as compared to U.S.$1,809 million for the year ended 2004.

Short-Term Debt

Our outstanding short-term debt serves mainly to support our imports of crude oil and oil products, and is provided almost completely by international banks and under our commercial paper program. At December 31,

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2005, our short-term debt (excluding current portions of long-term obligations) increased to U.S.$ 950 million as compared to U.S.$547 million at December 31, 2004. This increased use of short-term credit facilities was due to advantageous market conditions in Argentina.

Long-Term Debt

Our total outstanding consolidated long-term debt consists primarily of the issuance of securities in the international capital markets, debentures in the domestic capital markets, amounts outstanding under facilities guaranteed by export credit agencies and multilateral agencies, and financing from the *Banco Nacional de Desenvolvimento Econômico e Social* (the Brazilian National Development Bank, or BNDES) and other financial institutions. Outstanding long-term debt, plus the current portion of our long-term debt, totaled U.S.$12,931 million at December 31, 2005, as compared to U.S.$13,344 million at December 31, 2004. This decrease was a result of our decision to pay down some of our long-term obligations.

Included in these figures at December 31, 2005 are the following international debt issues:

Notes	Principal Amount	
10.00% Notes due 2006	U.S.$	250 million
6.625% Step Down Notes due 2007(1)	EUR	134 million
PIFCo s 9.125% Notes due 2007(2)	U.S.$	500 million
PIFCo s 9.875% Notes due 2008(2)	U.S.$	450 million
PIFCo s 6.75% Senior Trust Certificates due 2010(3)	U.S.$	95 million
PIFCo s Floating Rate Senior Trust Certificates due 2010(3)	U.S.$	55 million
PIFCo s 9.750% Notes due 2011(2)	U.S.$	600 million
PIFCo s 6.60% Senior Trust Certificates due 2011(3)	U.S.$	300 million
PIFCo s Floating Rate Senior Trust Certificates due 2013(3)	U.S.$	300 million
PIFCo s 4.750% Senior Exchangeable Notes due 2007(4)	U.S.$	338 million
PIFCo s Global Step-up Notes due 2008(5)	U.S.$	400 million
PIFCo s 9.125% Global Notes due 2013(6)	U.S.$	750 million
PIFCo s 8.375% Global Notes due 2018(6)	U.S.$	750 million
PIFCo s 3.748% Senior Trust Certificates due 2013(3)	U.S.$	200 million
PIFCo s 6.436% Senior Trust Certificates due 2015(3)	U.S.$	550 million
9.375% Notes due 2013(7)	U.S.$	100 million
PIFCo s 7.75% Global Notes due 2014(2)	U.S.$	600 million

(1) Euro; U.S.$1.1825 = EUR 1.00 at December 31, 2005.

(2) Issued by PIFCo, with support from us through a standby purchase agreement and with insurance against 18 months of inconvertibility

and transfer risk for interest payments.

(3) Issued by PIFCo in connection with a financing program supported by future sales of bunker fuel and fuel oil.

(4) Issued by PIFCo on October 17, 2002 in connection with Petrobras acquisition of Perez Companc S.A.

(5) The Global Step-up Notes bear interest from March 31, 2003 at a rate of 9.00 % per year until April 1, 2006 and at rate of 12.375% per year thereafter, with interest payable semi-annually. Issued by PIFCo, with support from us through a standby purchase agreement.

(6) Issued by PIFCo for general corporate purposes, with support from us through a standby purchase

agreement.

(7) Issued by PEPSA on October 31, 2003 to cancel existing liabilities.

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Project Finance

Since 1997, we have utilized project financings to provide capital for our large exploration and production and related projects, and more recently, for the development of natural gas processing and transportation systems. All of these projects, and their related debt obligations, were on-balance sheet and accounted for under the line item Project Financings until December 31, 2002. Since December 31, 2003, the special purpose companies related to these project financings are consolidated in accordance with FIN 46 on a line-by-line basis. Under the contractual arrangements, we are responsible for completing the development of the projects, their operation, paying all operating expenses relating to the projects and remitting a portion of the net proceeds generated from the fields to fund the special purpose companies debt and return on equity payments. At the end of each financing project, we have the option to purchase the project assets from the special purpose company or, in some cases, acquire control over the special purpose company itself. Outstanding project financings, plus the current portion of our project financings, totaled U.S.$6,042 million at December 31, 2005, as compared to U.S.$5,712 million at December 31, 2004.

During 2005, we made capital expenditures of U.S.$6,127 million (59.1% of our total capital expenditures) in connection with exploration and development projects in Brazil, mainly in the Campos Basin, a number of which are being financed through project financings.

Of the U.S.$1,799 million projected amount of expenditures for project financings in 2006, we expect that approximately U.S.$851 million will be used by our exploration and production segment and U.S.$948 million by our gas and energy segment. The amount of gas and energy segment will be applied directly by SPC s created for this finality.

At December 31, 2005, the long-term portion of project financings becomes due in the following years:

	U.S.$ million
2007	1,081
2008	743
2009	674
2010	500
2011	86
2012 and thereafter	545
Total	3,629

PIFCo

Overview

PIFCo finances its oil trading activities principally from commercial banks, including lines of credit and commercial paper programs, as well as through inter-company loans from us and the issuance of notes in the international capital markets. PIFCo s strong cash position at hand and its ability to access international capital markets will continue to allow it to meet its anticipated cash needs and financial obligations.

As an offshore non-Brazilian company, PIFCo is not legally obligated to receive prior approval from the Brazilian National Treasury to incur debt or register debt with the Central Bank. As a matter of policy, however, the issuance of any debt is recommended by any of our Chief Financial Officer, Executive Board or Board of Directors, depending on the aggregate principal amount and the tenor of the debt to be issued.

Sources of Funds

PIFCo s Cash Flow

At December 31, 2005, PIFCo had cash and cash equivalents of U.S.$230.7 million, as compared to U.S.$1,107.3 million at December 31, 2004. This decrease in cash was primarily a result of an increase in notes receivable issued to related parties, mainly to PIFCo s affiliate PNBV and its subsidiaries for the construction of

platforms. PIFCo s operating activities used net cash of U.S.$5.9 million in 2005, as compared to using net cash of U.S.$2,322.0 million in 2004, primarily as a result of a decrease in trade accounts receivable from related parties of U.S.$1,831 million. Such decrease was partially offset by an increase in export prepayments to related parties of U.S.$405 million and an increase in outstanding trade accounts payable for purchases from related parties of U.S.$98 million. PIFCo s investing activities used net cash of U.S.$2,271.0 million in 2005, as compared to using net cash of U.S.$1,406.2 million in 2004, primarily as a result of an increase in notes receivable issued to related parties. PIFCo s financing activities provided net cash of U.S.$1,400.3 million in 2005, as compared to providing net cash of U.S.$4,171.3 million in 2004, primarily as a result of a decrease in proceeds of loans from related parties.

Accounts Receivable

Accounts receivable from related parties increased 11.5% from U.S.$7,788.1 million at December 31, 2004 to U.S.$8,681.1 million at December 31, 2005, primarily as a result of a 38.1% increase in sales of oil and oil products to us, partially offset by an increase in our payments during the last quarter of 2005.

Notes Receivable and Other Current Assets

On December 28, 2005, in order to lend support to us in its transactions related to the Termobahia power plant, PIFCo entered into a series of agreements with Blade Securities Ltd., a special purpose company holding 49% of the equity shares of Termobahia (consolidated by us). Under the agreements, PIFCo paid to Blade U.S.$1.5 million, and in return, Blade transfers to PIFCo the right of any dividends to be received from Termobahia and the rights to the shares of Termobahia either for PIFCo or one of our subsidiaries. Additionally, PIFCo paid to Blade U.S.$38.2 million, and in return, Blade transfers to PIFCo any amounts received from Termobahia related to the subordinated loan recorded as notes receivable, which has an interest rate of 8% p.a. and an expiration date of 2023, and the right to the loans receivable for PIFCo or one of our subsidiaries. We have the intention of finding a strategic partner within one year s time frame to purchase the Termobahia equity interest and related loan.

PIFCo s Short-Term Borrowings

PIFCo s short-term borrowings are denominated in U.S. dollars and consist of lines of credit and loans payable. PIFCo s outstanding position at December 31, 2005 in irrevocable letters of credit was U.S.$369.5 million, as compared to U.S.$514.4 million at December 31, 2004. Considering only the issuance of irrevocable letters of credit supporting oil imports, PIFCo s outstanding position at December 31, 2005 was U.S.$300.6 million, as compared to U.S.$441.6 million at December 31, 2004. At December 31, 2005, PIFCo had accessed U.S.$493.6 million in lines of credit, including the current portion of long-term lines of credit, as compared to U.S.$535.8 million accessed at December 31, 2004. The weighted average annual interest rate on these short-term borrowings was 5.0% at December 31, 2005, as compared to 4.3% at December 31, 2004. At December 31, 2005, PIFCo had utilized all the proceeds from lines of credit for the purchase of imports.

The short-term portion of PIFCo s notes payable to related parties, which are principally composed of notes payable to us, increased 50.8% from U.S.$2,881.5 million at December 31, 2004 to U.S.$4,346.1 million at December 31, 2005, primarily as a result of PIFCo s short-term financing needs.

PIFCo s Long-Term Borrowings

PIFCo s long-term loans from us increased from U.S.$3,553.5 million at December 31, 2004 to U.S.$3,734.1 million at December 31, 2005, with interest rates ranging from 4.9% to 5.8% and due 2010.

At December 31, 2005, PIFCo had outstanding U.S.$1,194.7 million in long-term lines of credit due between 2007 and 2017, as compared to U.S.$631.8 million at December 31, 2004. PIFCo also had outstanding at December 31, 2005:

U.S.$1,550 million in three series of long-term Senior Notes due between 2007 and 2011.

U.S.$329.9 million in 4.75% Senior Exchangeable Notes due 2007, issued on October 17, 2002, in connection with our purchase of Perez Companc S.A. (currently known as Petrobras Energia

Participaciones PEPSA). In exchange, it received notes issued by Petrobras International Braspetro BV (PIB BV), a related party, in the same amount, terms and conditions as the Senior Exchangeable Notes. In connection with the acquisition of Perez Companc, PIFCo also provided PIB BV with a loan for U.S.$724.5 million, with an interest rate of 4.79%.

On September 1, 2005, PFL prepaid the floating rate Senior Trust Certificates (series A2 and C) in accordance with the applicable provisions of the governing agreements. In order to facilitate this advance payment, we prepaid to PFL an amount of U.S.$330.3 million related to the export prepayment program. On March 1, 2006, PFL prepaid the fixed rate Senior Trust Certificates (series A1 and B) in accordance with the applicable provisions of the governing agreements in the amount of US$333.9 million.

An investment fund, operated exclusively for PIFCo, holds certain of our own and PIFCo s group securities, among its other investments. These repurchased securities are considered to be extinguished and thus reduce PIFCo s short and long-term financing balance by U.S.$210.9 million at December 31, 2005. In 2005, a loss on debt extinguishment expense was registered in the amount of U.S.$11.7 million representing the difference between the book value and the market value of the repurchased securities.

At December 31, 2005, PIFCo had available standby committed facilities in the amount of U.S.$675.0 million, which are not specific as to use requirements. PIFCo has no drawn down amounts related to these facilities and do not have a scheduled date for the drawdown.

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The following table shows the sources of PIFCo s current and long-term debt at December 31, 2005 and 2004:

CURRENT AND LONG-TERM DEBT

	December 31, 2005		December 31, 2004	
	(in millions of U.S. dollars)			
	Current	Long-term	Current	Long-term
Financing institutions	U.S.$493.6	U.S.$1,194.7	U.S.$535.8	U.S.$631.8
Senior notes	53.5	1,550.0	53.5	1,550.0
Global Step-up Notes	9.0	400.0	9.0	400.0
Global Notes	26.3	2,115.3	26.3	2,124.2
Sale of rights to future receivables	567.4	679.4	153.7	1,561.9
Senior exchangeable notes	3.7	329.9	3.8	329.9
Assets related to export prepayment to be offset against sales of rights to future receivables	(150.0)	(150.0)		(300.0)
Repurchased securities	(4.7)	(210.9)	(3.2)	(146.0)
	U.S.$998.8	U.S.$5,908.4	U.S.$778.9	U.S.$6,151.8

Extinguished securities

At December 31, 2005 and 2004, we had amounts invested abroad in an exclusive investment fund that held debt securities of some of our group companies in the amount of U.S.$2,078 million and U.S.$ 2,013 million, respectively. Once these securities are purchased by the fund, the related amounts, together with applicable interest, are removed from the presentation of marketable securities and long-term debt.

Off Balance Sheet Arrangements

As noted above, all of our project financings are on-balance sheet. At December 31, 2005, neither we nor PIFCo had off-balance sheet arrangements that have, or are reasonably likely to have, a material effect on our or PIFCo s financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

Uses of Funds

Capital expenditures

In 2005, we continued to prioritize capital expenditures for the development of crude oil and natural gas production projects through internal investments and through structured undertakings with partners. We invested a total of U.S.$10,365 million in 2005, a 34.3% increase from our investments in 2004. Our increased capital expenditures in 2005 were primarily directed towards increasing our production capabilities in the Campos Basin, upgrading our refineries and expanding our pipeline transportation and distribution system. We spent U.S.$6,127 million (59.1%) in 2005 in our domestic exploration and development projects mainly in the Campos Basin, which includes investments financed through our project financings. PIFCo primarily utilizes funds to finance its oil trading activities.

The following table sets forth our consolidated capital expenditures (including project financings and investment in gas-fired power plants) for each of our business segments for 2005, 2004 and 2003:

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CONSOLIDATED CAPITAL EXPENDITURES

	For the Year Ended December 31,		
	2005	2004	2003
	(in millions of U.S. dollars)		
Exploration and Production	$ 6,127	$ 4,574	$ 3,658
Supply	1,749	1,367	1,451
Distribution	207	47	106
Gas and Energy	694	782	694
International			
Exploration and Production	1,067	666	428
Supply	79	43	18
Distribution	16	12	33
Gas and Energy	13	6	1
Corporate	413	221	162
Total	$ 10,365	$ 7,718	$ 6,551

On August 19, 2005, we announced our Strategic Plan, which contemplates total budgeted capital expenditures of U.S.$56.4 billion from 2006 to 2010, approximately U.S.$49.3 billion of which will be directed towards our activities in Brazil, while U.S.$7.1 billion will be directed to our activities abroad. We expect that the majority of our capital expenditures from 2006 to 2010, approximately U.S.$34.1 billion, will be directed towards exploration and production, of which U.S.$28 billion is slated for our activities in Brazil.

Our Strategic Plan through 2010 contemplates greater domestic expenditures in our construction activities and other projects. We estimate that of the U.S.$49.3 billion in domestic capital expenditures through 2010, at least U.S.$32.0 billion (65%) will be utilized to pay for equipment and services provided by Brazilian contractors, suppliers and other service providers.

Our capital expenditures budget for the year 2006, including our project financings, is U.S.$ 15.4 billion, allocated among each of our business segments as follows: (i) Exploration and Production: U.S.$7.5 billion; (ii) Downstream: U.S.$2.0 billion; (iii) International: U.S.$2.4 billion; (iv) Gas and Energy: U.S.$2.7 billion; (v) Distribution: U.S.$0.3 billion; and (vi) Corporate: U.S.$0.5 billion.

We plan to meet our budgeted capital expenditures primarily through internally generated cash and issuances in the international capital markets. Our actual capital expenditures may vary substantially from the projected numbers set forth above as a result of market conditions and the cost and availability of the necessary funds.

Dividends

In 2005 we paid dividends of approximately U.S.$2,110million (U.S.$0.48 per share). Approximately 87% of such amount was paid in the form of interest on capital.

At the Ordinary General Meeting held on April 3, 2006, our shareholders approved dividends in the amount of U.S.$2,998 million (U.S.$0.68 per share). This dividend includes interest on capital approved by the Board of Directors on June 17, 2005, in the amount of U.S.$933 million (U.S.$0.21 per share), which was made available to shareholders on January 5, 2006, based on the shareholding position of June 30, 2005. The dividend also includes interest on capital approved by the Board of Directors on December 16, 2005, which was made available on March 22, 2006 based on the shareholding position of December 31, 2005, in the amount of U.S.$939 million (U.S.$0.21 per share), and an additional parcel, approved by the Board of Directors on February 17, 2006, in the amount of U.S.$468 million (U.S.$0.11 per share), based on the shareholding position of April 03, 2006. All such payments are made in *reais* and are monetarily restated as of December 31, 2005 up to the date of actual payment according to the

variation of the SELIC rate. All per share values and dividends have been restated for the 4 to 1 stock split effective September 1, 2005. See Note 19 to our audited consolidated financial statements for the year ended December 31, 2005.

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Contractual obligations

Petrobras

The following table summarizes our outstanding contractual obligations at December 31, 2005:

OUTSTANDING CONTRACTUAL OBLIGATIONS

		Payments due by period (in millions of U.S. dollars)			
	Total	**Less than 1 year**	**1-3 years**	**3-5 years**	**More than 5 years**
Contractual Obligations:					
Balance Sheet Items:					
Long-Term Debt Obligations	13,881	2,378	3,556	2,253	5,694
Pension Fund Obligations(1)	14,422	722	1,638	1,956	10,106
Project Finance Obligations	6,042	2,413	1,824	1,174	631
Capital (Finance) Lease Obligations	1,254	239	443	399	173
Total Balance Sheet Items	35,599	5,752	7,461	5,782	16,604
Other Long-Term Contractual Obligations:					
Natural Gas Ship-or-Pay Commitments	6,933	488	983	991	4,471
Contract Service Obligations	7,343	3,124	3,264	640	315
Natural Gas Supply Agreements	7,275	769	1,260	966	4,280
Operating Lease Obligations	5,917	1,712	2,688	1,162	355
Purchase Obligations	1,546	765	715	66	
International Purchase Obligations	2,999	421	616	554	1,408
Total Other Long-Term Contractual Obligations	32,013	7,279	9,526	4,379	10,829
Total	67,612	13,031	16,987	10,161	27,433

(1) There are pension plan assets in the amount of U.S.$9,413 million that guarantee the pension plan obligations. These assets are presented as a reduction to the net actuarial liabilities. See Note 18 to our audited consolidated financial statements for the year ended December 31,

2005.

PIFCo

The following table summarizes PIFCo s outstanding contractual obligations at December 31, 2005, excluding deferred income tax and trade accounts payable.

OUTSTANDING CONTRACTUAL OBLIGATIONS

		Payments due by period (in millions of U.S. dollars)			
	Total	**less than 1 year**	**1-3 years**	**3-5 years**	**more than 5 years**
Contractual Obligations					
Long-term debt	6,460.0	551.6	2,094.8	535.5	3,278.1
Notes Payable Long term	3,734.1			3,734.1	
Purchase obligations Long term	3,041.1	473.4	946.7	893.5	727.5
Total	13,235.2	1,025.0	3,041.5	5,163.1	4,005.6

Risk Management Activities

We and PIFCo are exposed to a number of market risks arising in the normal course of business. We and PIFCo may use derivative and non-derivative instruments to manage these risks. For a description of our risk management activities, see Item 11. Qualitative and Quantitative Disclosures About Market Risk.

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Critical Accounting Policies and Estimates

The following discussion describes those areas that require the most judgment or involve a higher degree of complexity in the application of the accounting policies that currently affect our financial condition and results of operations. The accounting estimates we make in these contexts require us to make assumptions about matters that are highly uncertain. In each case, if we had made other estimates, or if changes in the estimates occur from period to period, our financial condition and results of operations could be materially affected.

The discussion addresses only those estimates that we consider most important based on the degree of uncertainty and the likelihood of a material impact if we used a different estimate. There are many other areas in which we use estimates about uncertain matters, but the reasonably likely effect of changed or different estimates is not material to our financial presentation.

Oil and Gas Reserves

Evaluations of oil and gas reserves are important for the effective management of upstream assets. They are used to make investment decisions about oil and gas properties. Oil and gas reserve quantities are also used as the basis for calculation of unit-of-production rates for depreciation and evaluation for impairment. Oil and gas reserves are divided between proved and unproved reserves. Proved reserves are estimated quantities of crude oil, natural gas and natural gas liquids that geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions, i.e., prices and costs as of the date the estimate is made. Unproved reserves are those with less than reasonable certainty of recoverability and are classified as either probable or possible. Probable reserves are reserves that are more likely to be recovered than not and possible reserves are less likely to be recovered.

The estimation of proved reserves is an ongoing process that takes into account engineering and geological information such as well logs, pressure data and fluid sample core data. Proved reserves can also be divided in two categories: developed and undeveloped. Developed proved reserves are expected to be recovered from existing wells including line pack, or when the costs necessary to put them in production are relatively low. For undeveloped proved reserves, significant investments are necessary, including drilling new wells and installing production or transportation facilities.

We use the successful efforts method to account for our exploration and production activities. Under this method, costs are accumulated on a field-by-field basis with certain exploratory expenditures and exploratory dry holes being expensed as incurred. Exploratory wells that find oil and gas in an area requiring major capital expenditure before production can begin are evaluated annually to ensure that commercial quantities of reserves have been found or that additional exploration work is under way or planned in a timeframe reasonable for the Petrobras development cycle and with consideration to ANP timing requirements. Exploratory well costs not meeting either of these criteria are charged to expense. Costs of productive wells and development dry holes are capitalized and amortized on the unit-of-production method because it provides a more timely accounting of the success or failure of our exploration and production activities.

Impact of Oil and Gas Reserves on Depreciation and Depletion

The calculation of unit-of-production depreciation and depletion is a critical accounting estimate that measures the depreciation and depletion of upstream assets. It is the ratio of (1) actual volumes produced to (2) total proved developed reserves (those proved reserves recoverable through existing wells with existing equipment and operating methods) applied to (3) asset cost. Proved undeveloped reserves are considered in the amortization of leasehold acquisition costs. The volumes produced and asset cost are known and while proved developed reserves have a high probability of recoverability they are based on estimates that are subject to some variability. This variability may result in net upward or downward revisions of proved reserves in existing fields, as more information becomes available through research and production. We revised our proved reserves in the last three years, increasing our proved reserves by 258.4 million barrels of oil equivalent in 2005, decreasing our proved reserves by 431.3 million barrels of oil equivalent in 2004 and decreasing our proved reserves by 665.5 million barrels of oil equivalent in 2003. While the revisions we have made in the past are an indicator of variability, they have had a small impact on the unit-of-production rates because they have been small compared to our total reserve base.

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Impact of Oil and Gas Reserves and Prices on Testing for Impairment

At December 31, 2005, our property, plant, and equipment, net of accumulated depletion, amounted to U.S.$46 billion. A substantial part of this amount consisted of oil and gas producing properties. These properties are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amounts may not be recoverable. We estimate the future and discounted cash flows of the affected properties to judge the recoverability of carrying amounts. In general, analyses are based on proved reserves, except in circumstances where it is probable that additional non-proved reserves will be developed and contribute to cash flows in the future; the percentage of probables that we include in cash flows does not exceed our past success ratios in developing probable reserves.

We perform asset valuation analyses on an ongoing basis as a part of our management program. These analyses monitor the performance of assets against corporate objectives. They also assist us in reviewing whether the carrying amounts of any of our assets may not be recoverable. In addition to estimating oil and gas reserve volumes in conducting these analyses, it is also necessary to estimate future oil and gas prices.

In general, we do not view temporarily low oil prices as a trigger event for conducting impairment tests. The markets for crude oil and natural gas have a history of significant price volatility. Although prices will occasionally drop precipitously, industry prices over the long term will continue to be driven by market supply and demand fundamentals. Accordingly, any impairment tests that we perform make use of our long-term price assumptions for the crude oil and natural gas markets. These are the same price assumptions that are used in our planning and budgeting processes and our capital investment decisions, and they are considered to be reasonable, conservative estimates given market indicators and past experience. Significantly lower future oil and gas prices could lead to impairments in the future, if such decreases were considered to be indicative of long-term trends. Additionally, significant changes in production curve expectation, discount and/or required production and lifting costs, could affect impairment analysis. While such uncertainties are inherent to this estimation process, the amount of impairment charges in past years has been small relative to the total value of oil and gas producing properties: U.S.$156 million in 2005, U.S.$65 million in 2004 and U.S.$70 million in 2003.

Pension and Other Post-Retirement Benefits

The determination of the expense and liability relating to our pension and other post-retirement benefits involves the use of judgment in the determination of actuarial assumptions. These include estimates of future mortality, withdrawal, changes in compensation and discount rate to reflect the time value of money as well as the rate of return on plan assets. These assumptions are reviewed at least annually and may differ materially from actual results due to changing market and economic conditions, regulatory events, judicial rulings, higher or lower withdrawal rates or longer or shorter life spans of participants.

According to the requirements of SFAS 87, and subsequent interpretations, the discount rate should be based on present value for settling the pension obligation. Applying the precepts of SFAS 87 in historically inflationary environments such as Brazil creates certain issues to the extent that the ability for a company to settle a pension obligation at a future point in time may not exist because long-term financial instruments of suitable grade may not exist locally as they do in the United States.

Although the Brazilian market has been demonstrating signs of stabilization as reflected in market interest rates, it is not yet prudent to conclude that market interest rates will be stable. Although SFAS 87 offers limited guidance, we consider it appropriate to use actuarial assumptions, which include an estimate of long-term inflation (i.e., nominal rates).

On December 31, 2004, we adopted a new actuarial methodology for calculation of Accumulated Benefit Obligation (ABO), by excluding the effects of long-term inflation. In the past, we had applied in the calculation of our ABO, an approach permitted under EITF 88-1. At December 31, 2004, we elected a change in methodology to a going concern calculation of the ABO, a more preferable application of principle per EITF 88-1. The change in accounting principle application impacted only the liability balance and amount not recognized in the shareholders equity having no effect in our income statement for 2004. This methodology change will affect the results for the years subsequents to 2004 by the increase of expenses related to the amortization of unrecognized actuarial losses. In 2005 this methodology change increased pension plan expenses in the amount of U.S.$100 million.

In addition, in 2004, our Executive Board approved a change to the mortality table relating to actuarial assumptions of our pension and healthcare plans in Brazil. This new mortality table reflects changes with respect to the profile of employees, retirees and pensioners, based on longevity, age of invalidity and invalid mortality tables. The main purpose of the change was to strengthen our benefit plans in light of a more accurate evaluation of the greater life expectancy of the plan beneficiaries.

The progressive increase in longevity has direct impact on the plan s estimated and provisioned volume of commitments and obligations and in our liabilities under the line employees post-retirement benefit obligation and our shareholders equity under the line amounts not recognized as net periodic pension cost, net of tax. The restated estimates have no impact in the results for the fiscal year ended December 31, 2004.

The change of the mortality table has been affecting the results for the years subsequent to 2004 due to an increase of expenses related to the interest costs and amortization of unrecognized actuarial losses. In 2005 these expenses increased by U.S.$212 million.

Amounts not recognized as net periodic pension cost are values calculated as the difference between the forecasted restatement of the net value of the obligations according to the actuarial assumptions and the variations effectively occurring over time. These amounts are to be amortized and posted to the results of subsequent fiscal years over the average life expectancy of the pension plan s members.

Litigation, Tax Assessments and Other Contingencies

Claims for substantial amounts have been made against us arising in the normal course of business. We are sometimes held liable for spills and releases of oil products and chemicals from our operating assets. In accordance with the guidance provided by U.S. GAAP, we provisioned for these costs when it is probable that a liability has been incurred and reasonable estimates of the liability can be made. At December 31, 2005, we had provisioned U.S.$235 million for litigation contingencies. Significant management judgment is required to comply with this guidance and it includes management s discussion with our attorneys, taking into account all of the relevant facts and circumstances. We believe that payments required to comply with these laws and regulations will not vary significantly from our estimated costs, and thus will not have a material adverse effect on our operations or cash flows. In past periods, the difference between the actual payout and the amount of the provision liability, with respect to contingency estimation, has been insignificant, with no material income statement impact in the period of the payout. In the last five years, our annual cash payouts for contingencies relating to claims against Petrobras, the parent company, reached an average of U.S.$58 million per year.

Asset Retirement Obligations and Environmental Remediation

Under various contracts, permits and regulations, we have material legal obligations to remove equipment and restore the land or seabed at the end of operations at production sites. Our most significant asset removal obligations involve removal and disposal of offshore oil and gas production facilities worldwide. We accrue the estimated discounted costs of dismantling and removing these facilities at the time of installation of the assets. We also estimate costs for future environmental clean-up and remediation activities based on current information on costs and expected plans for remediation. The aggregate amount of estimated costs on a discounted basis for asset retirement and environmental remediation provision at December 31, 2005 was U.S.$842 million. Estimating asset retirement, removal and environmental remediation costs requires performing complex calculations that necessarily involve significant judgment because our obligations are many years in the future, the contracts and regulation have vague descriptions of what removal and remediation practices and criteria will have to be met when the removal and remediation events actually occur and asset removal technologies and costs are constantly changing, along with political, environmental, safety and public relations considerations. Consequently, the timing and amounts of future cash flows are subject to significant uncertainty. However, given the significant amount of time to the ultimate retirement date, any modifications in technological specifications, legal requirement, or other matters, would not have a materially adverse effect on any one reporting period.

In 2005, we reviewed and revised our estimated costs associated with well abandonment and the demobilization of oil and gas production areas, considering new information about date of expected abandonment and revised cost estimates to abandon. The changes to estimated asset retirement obligation were principally related

to changing expectations about Brent prices, which led the correlated fields to have longer economic lives. This review resulted in a decrease in the related provision of U.S.$21 million with a gain recognized in net income, and recorded in the line titled exploratory costs for oil and gas exploration. See note 2(i) to our audited consolidated financial statements. See note 2(i) to our audited consolidated financial statements, as of December 31, 2005.

Derivative transactions

SFAS 133 requires that we recognize all derivatives as either assets or liabilities in the balance sheet and measure those instruments at fair value. Accounting for derivative transactions requires us to employ judgment to arrive at assumptions to compute fair market values, which are used as the basis for recognition of the derivative instruments in the financial statements. Such measurement may depend on the use of estimates such as estimated future prices, long term interest rates and inflation indexes, and becomes increasingly complex when the instrument being valued does not have counterparts with similar characteristics traded in an active market.

In the course of our business we have entered into contracts that meet the definition of derivatives under SFAS 133, certain of which have not qualified to receive hedge accounting. For the majority of these contracts, the estimates involved in the calculations for the fair value of such derivative instruments have not been considered likely to have a material impact in our financial position had we used different estimates, due to the majority of our derivative instruments being traditional over the counter instruments with short term maturities.

Impact of New Accounting Standards

FSP SFAS 19-1

The Financial Accounting Standards Board (FASB) adopted FASB Staff Position (FSP SFAS 19-1) on April 4, 2005, which amends SFAS 19 to permit the continued capitalization of exploratory well costs beyond one year if (a) the well found a sufficient quantity of reserves that justify its completion as a producing well and (b) the entity is making sufficient progress assessing the reserves and the viability of the project. The guidance in FSP SFAS 19-1 was applied prospectively starting in the third quarter of 2005. We experienced no material effect on our financial position or results from operations from the adoption of FSP SFAS 19-1. (See note 27 to our audited consolidated financial statements, as of December 31, 2005).

SFAS 151

In November of 2004, FASB issued SFAS No. 151, Inventory Costs, an amendment of ARB Nº 43, Chapter 4 , Inventory Pricing , (SFAS 151). SFAS 151 became effective for us on January 1, 2006. The standard amends the guidance in Accounting Research Bulletin (ARB) No. 43, Chapter 4, Inventory Pricing, to clarify the accounting procedures for abnormal amounts of idle facility expense, freight, handling costs and spoilage. In addition, the standard requires that the allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. We do not expect the adoption of this standard to have a material impact on our financial statements.

SFAS 153

In December of 2004, FASB issued FASB Statement No. 153, Exchanges of Non-monetary Assets An Amendment of APB Opinion No. 29 , (SFAS 153). SFAS 153 became effective for us for asset-exchange transactions beginning on July 1, 2005. Under APB No. 29, assets received in certain types of non-monetary exchanges were permitted to be recorded at the carrying value of the assets that were exchanged (i.e., recorded on a carryover basis). As amended by SFAS 153, assets received in some circumstances must be recorded instead at their fair values. In the past, we did not engage in a large number of non-monetary asset exchanges for significant amounts, and thus the amendment did not have a material impact upon adoption.

SFAS 154

Issued in December 2004, SFAS No. 154, Accounting Charges and Error corrections requires retrospective application of changes in accounting principles to financial statements from prior periods, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. When it is

impracticable to determine the period specific effects of an accounting change on one or more individual prior periods presented, this Statement requires that the new accounting principle be applied to the balances of assets and liabilities as of the beginning of the earliest period for which retrospective application is practicable and that a corresponding adjustment be made to the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position) for that period rather than being reported in an income statement. When it is impracticable to determine the cumulative effect of applying a change in accounting principle to all prior periods, this Statement requires that the new accounting principle be applied as if it were adopted prospectively from the earliest date practicable. This Statement shall be effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005.

SFAS No. 155

Issued in February 2006, SFAS No. 155, Accounting for Certain Hybrid Financial Instruments , allows certain financial instruments that have embedded derivatives to be accounted for as a whole (eliminating the need to split off the derivative from its host) if the holder elects to account for the whole instrument on a fair value basis. This Statement is effective for all financial instruments acquired or issued after the beginning of an entity s first fiscal year that begins after September 15, 2006. We do not expect that the adoption of SFAS 155 will have a material effect on our financial position or results from operations.

SFAS 123R

In December 2004, the FASB issued a revised Statement of Financial Accounting Standards SFAS No. 123R that requires that compensation costs relating to share-based payments be recognized in our financial statements. Petrobras Energia S.A.-PEPSA, a member of PETROBRAS System, currently accounts for those payments under the recognition and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. When adopted, SFAS No. 123R is expected to have a minimal impact on our results of operations, financial position and liquidity.

FIN 47

FASB issued FASB Interpretation No 47, Accounting for Conditional Asset Retirement Obligations, in March of 2005, effective December 31, 2005. FIN 47 clarifies the term conditional asset retirement obligation as used SFAS143 in order to avoid diversity in accounting practice with respect to the effect of uncertainties about the timing and/or method of settlement that are conditional on a future event, when recognizing the fair value of a liability for an asset retirement obligation. FIN 47 also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. The adoption of FIN 47 did not have a material effect on our financial position or results from operations as of December 31, 2005.

FSP FAS 115-1 and FAS 124-1

FSP FAS 115-1 and FAS 124-1, The Meaning of Other Than Temporary Impairment and its Application to Certain Investments , was issued in November 2005. FSP FAS 115-1 replaces the impairment evaluation guidance of EITF issue No. 03-1 with reference to the existing guidance, but temporary impairment guidance and EITF 03-1 disclosure requirements are maintained. The guidance is to be applied to reporting periods beginning after December 15, 2005. We do not expect adoption to have a material impact on our results from operations.

EITF Issue No. 04-13

At its September 2005 meeting, the Emerging Issues Task Force (EITF) reached a consensus on Issue No. 04-13, Accounting for Purchases and Sales of Inventory with the Same Counterparty. This issue addresses the question of when it is appropriate to measure purchases and sales of inventory at fair value and record them in cost of sales and revenues and when they should be recorded as exchanges measured at the book value of the item sold. The EITF concluded that purchases and sales of inventory with the same counterpart that are entered into in contemplation of one another should be combined and recorded as exchanges measured at the book value of the item sold. We reviewed our buy and sell contracts and have estimated that, if those contracts were required to be reported

net, sales of products and services, net operating revenues and cost of sales would be reduced by U.S.$60 million for 2005 with no impact on net income.

Research and Development

Since 1966, we have maintained a dedicated research and development facility in Rio de Janeiro, Brazil. As of December 31, 2005, we had 1569 employees working in this facility. We engage in joint research projects with universities and other research centers in Brazil and abroad. We spent U.S.$54 million in 2005 on joint projects with Brazilian universities and technological institutions, as compared to U.S.$32 million in 2004 and U.S.$28.5 million in 2003. Additionally, we participate in technology exchange and assistance projects with other oil and gas and oil field service companies for other areas of our business. These transfers of technology are based on partnership agreements focusing on the exchange of information with respect to offshore systems and development of deepwater technologies and involve no material cost to us.

Our research and development facility researches various aspects of our oil and gas operations, including exploration, drilling, production, reservoir engineering and geology, fluid separation, well completion and refining process technology. This facility also engages in research on industrial catalysts, lubricants, fine chemicals, fuels, additives, petrochemicals and polymers for other areas of our business. Our research facility is also responsible for the basic design of new offshore fixed and semi-submersible platforms and subsea production systems, as well as new and reconstructed refining units, and has facilitated the development of important technologies, including semi-submersible production platforms capable of operating in water depths of up to 3,000 meters (9,843 feet).

As of December 31, 2005, we had 27 floating production systems in operation (13 semi-submersibles, 13 FPSO and 1 FSO). We have obtained 56 patents in Brazil and 156 abroad for a significant number of the technologies produced through research and development activities during the three-year period ended December 31, 2005.

Of the projects in which we are currently involved, three programs are key to our technological development activities. The first program, originally named PROCAP, is devoted to deepwater offshore activities and has been implemented in phases. The first phase, named simply PROCAP, started in 1986, to research deepwater technology to enable us to develop fields discovered in water depths up to 1,000m (3,281 ft), aiming at development in the recently discovered fields of Albacora and Marlim, at the Campos basin. In 1992, after successful conclusion and implementation of the first phase, we launched the second phase, PROCAP 2000, which pursued the same objectives of PROCAP but for depths up to 2,000m (6,562ft), by the year 2000. Following the discovery of the Roncador field, the third phase, PROCAP 3000, was started in 2000, with a budget of U.S.$128 million over five years to provide technological solutions to produce and support the development of ultra-deep water fields, in water as deep as 3,000m (9,843ft). The targets were the next phases of development of Marlim Sul, Roncador, Marlim Leste, Albacora Leste, Jubarte, the deep and ultra-deep blocks of the Santos and Espírito Santo basins, the Gulf of Mexico and West Africa, in order to achieve production and extraction in water depths up to 3,000 meters (9,843 feet). The total direct expenditure for PROCAP 3000 in 2005 was about U.S.$29 million. The budget for 2006 is nearly U.S.$70 million, signaling increased R&D activities in deep water over the past few years.

The second program, the Renewable Energy Technology Program PROGER was created in 2004 to promote the research and development of technologies to enable and optimize the use of renewable energy sources. Such sources provide light, heating, air conditioning, mechanical force, transportation, telecommunications and fuel with minimum impact to the environment, reducing the effects of world climate changes caused by the use of hydrocarbons. The challenge we face with this program is to make the use of such energy sources more economical and to enable their widespread use. This program focuses on the research and development of wind energy, solar energy, biomass energy, bio-fuels (including bio-diesel), and energy from the sea and geo-thermal energy, among other sources.

The third program, the Strategic Refining Technological Program PROTER, was created in 1994 to develop heavy crude oil refining technologies to optimize the capacity of existing facilities and to increase the bottom of the barrel conversion. This program has a portfolio of projects targeting the development of new technologies and the optimization of existing ones for our domestic heavy oil refining in a cost-effective way. We have been making substantial investments to accomplish this goal to provide the market with premium fuels and

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high added value products. These developments are carried out in our modern labs and pilot plants and sometimes a prototype technology evaluation is also needed before availability for industrial use. Many innovations developed under this program have been implemented in our refineries. In addition to these programs, we have developed several other programs designed to:

- decrease and control the environmental impact caused by our activities;
- increase our oil reserves and production through the improvement of our oil recovery levels;
- reduce the geological risk and the exploration costs associated with the exploration of hydrocarbons;
- create oil products meeting new market demands and stricter environmental controls;
- improve the reliability, performance and duration of pipelines and reduce the operational costs, investments and risks associated with pipelines;
- improve refining systems and procedures to reduce the costs associated with refining;
- develop technologies for the exploration and production of heavy oils in offshore fields;
- promote the use of natural gas; and
- provide and anticipate technological solutions and knowledge in physical and numerical simulations of geological processes, and in data base management of parameters for basin modeling.

PIFCo does not engage in research and development.

Market Trend

Crude oil prices

International oil prices increased at a record rate in 2005. The main factors driving this price increase include:

- the substantial growth in demand for oil products, with little impact resulting from the oil price increase;
- increased pressure on oil production and refining facilities;
- conflicts in the Middle East; and
- speculation in the oil futures market.

Although our oil prices are influenced by international oil prices, the price we charge for oil is generally lower than Brent prices. The main reasons for such spread relate to the fact that the oil we produce is heavier, which requires more refining expenses, and there is less refining capacity available capable of processing our heavy oil. This tendency continued in 2005, as in 2004.

Oil products prices

The prices for fuel oil did not grow as much as other oil products. With the increase in demand for oil products, refineries used more heavy oil that produces more residues, including fuel oil, than light oil. Because the demand was concentrated on light and medium oil products, there was an excess supply of fuel oil. This generated an increase in the price difference between heavy and light oil products.

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Refining

The use of substantially all available refining capacity in 2004 resulted in a year of record profit margins for the refining industry, despite the fact that the effects of hurricanes Rita and Katrina were a stress on the refining system.

We expect that several of the structural factors contributing to growth in demand in 2004 will continue to influence the market. As a result, we believe that the trends described above will continue in the next few years.

For a description of other trends that might affect our financial condition and results of operation, see Item 4. Information on the Company Competition.

ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

Directors and Senior Management

Directors of Petrobras

Our board of directors is composed of a minimum of five and a maximum of nine members and is responsible for, among other things, establishing our general business policies. The members of the board of directors are elected at the annual general meeting of shareholders.

Under Brazilian Corporate Law, shareholders representing at least 10% of the company s voting capital have the right to demand that a cumulative voting procedure be adopted to entitle each common share to as many votes as there are board members and to give each common share the right to vote cumulatively for only one candidate or to distribute its votes among several candidates.

Furthermore, our bylaws enable (i) minority preferred shareholders that together hold at least 10% of the total capital stock (excluding the controlling shareholders) to elect and remove one member to our board of directors; and (ii) minority common shareholders to elect one member to our board of directors, if a greater number of directors is not elected by such minority shareholders by means of the cumulative voting procedure. Our bylaws provide that, regardless of the rights above granted to minority shareholders, the Brazilian government always has the right to elect the majority of our directors, independently of their number. Additionally, as per Law 10.683, dated May 28, 2003, one of the Board members elected by the Brazilian government must be indicated by the Minister of Planning Budget and Management. The maximum term for a director is one year, but re-election is permitted. In accordance with the Brazilian Corporate Law, the shareholders may remove any director from office at any time with or without cause at an extraordinary meeting of shareholders. Following an election of board members under the cumulative vote procedure, the removal of any board member by an extraordinary meeting of shareholders will result in the removal of all the other members, after which new elections must be held.

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We currently have nine directors. The following table sets forth certain information with respect to these directors:

BOARD OF DIRECTORS OF PETROBRAS

Name	Date of Birth	Position	Current Term	Business Address
Dilma Vana Rousseff (1)	Dec. 14, 1947	Chair	March 2007	Casa Civil Praça dos Três Poderes Palácio do Planalto 4º andar Salas 57 e 58 Cep 70.150-900 Brasília DF
Silas Rondeau Cavalcanti Silva (1)	Dec. 15, 1952	Member	March 2007	Esplanada dos Ministérios Bloco U 8º andar Sala 809 Cep 70.065-900 Brasília DF
Guido Mantega (1)	Apr. 7, 1949	Member	March 2007	Esplanada dos Ministérios, Bloco P - 5º andar Ministério da Fazenda Cep 70.048-900 - Brasília DF
J.S. Gabrielli de Azevedo (1)	Oct. 3, 1949	Member	March 2007	Avenida República do Chile, nº 65 23º andar Centro 20031-912 Rio de Janeiro RJ
Gleuber Vieira (1)	Dec. 08, 1933	Member	March 2007	Rua Álvaro Moreira, 129, Condomínio Jardim Marapendi 22630-160, Barra da Tijuca RJ
Arthur Antonio Sendas (1)	Jun. 16, 1935	Member	March 2007	Rodovia Presidente Dutra, 4.674 25565-350 , São João de Meriti RJ
Roger Agnelli (1)	May 3, 1959	Member	March 2007	Rua Graça Aranha, 26 18º andar Rio de Janeiro RJ CEP 20.030-900
Fabio Colletti Barbosa (2)	Oct. 3, 1954	Member	March 2007	Av. Paulista, 1374, 3º andar, Cerqueira César 01310-916, São Paulo SP
Jorge Gerdau Johannpeter (3)	Dec. 8, 1936	Member	March 2007	Av. Farrapos, 1811 90220-005, Porto Alegre RS

(1) Appointed by the controlling shareholder.

(2) Appointed by the minority common shareholders.

(3) Appointed by the minority preferred shareholders.

Dilma Vana Rousseff Ms. Rousseff has been the Chair of our Board of Directors since January 3, 2003 and is also a member of the Board of Directors of Petrobras Distribuidora S.A. - BR. She has been the Minister s Chief of Staff in Brazil since June 14, 2005. She also served as: Minister of Mines and Energy of Brazil (2003-2005); State Secretary of Energy, Mines and Communications of the State of Rio Grande do Sul (1993-1994 and 1999-2002); President of the *Fundação de Economia e Estatística do Estado do Rio Grande do Sul* (Economy and Statistics Foundation of the State of Rio Grande do Sul, 1991-1993); and Secretary of Finance of Porto Alegre (1986-1988). Ms. Rousseff has also participated, as Coordinator of the Infrastructure Group, in the previous Governmental Transition Team, which was created to facilitate the transition of power to the current government. Ms. Rousseff has a Bachelors Degree in Economics from the Federal University of Rio Grande do Sul (1977), a Masters Degree in Economic Theory from the University of Campinas, São Paulo (1979) and is currently pursuing a Doctorate Degree in Monetary and Financial Economy at the University of Campinas.

Silas Rondeau Cavalcante Silva Mr. Silva has been a member of our Board of Directors since April 3, 2006 and is also a member of the Board of Directors of Petrobras Distribuidora S.A. BR. He is the Minister of Mines and Energy of Brazil since July 8, 2005. Mr. Silva has a degree in Electrical Engineering from the Federal University of Pernambuco (UFPE) and a specialized degree in Transmission Lines Engineering from the Federal University of Rio de Janeiro (UFRJ). Mr. Silva also served as the President of Eletrobras (2004-2005), Eletronorte (2003-2004), Manaus Energia (2000-2002), Energy Company of Amazonas (2000-2002) and Boa Vista Energia (2002-2003).

Guido Mantega Mr. Mantega has been a member of our Board of Directors since April 3, 2006 and is also a member of the Board of Directors of Petrobras Distribuidora S.A. BR. He has been the Minister of Finance of Brazil since March 28, 2006. Mr. Mantega received a Bachelor s Degree in Economics from the School of Economics and Administration at the University of São Paulo in 1971 and a PhD in Development Sociology from the Philosophy, Sciences and Liberal Arts School at the University of São Paulo, and he also completed specialized studies at the Institute of Development Studies (IDS) at the University of Sussex, England in 1977. He was a Professor of Economics at the Catholic University of São Paulo s (PUC-SP) Master s and PhD programs from 1982 to 1987 and Deputy Dean of the Catholic University of São Paulo (PUC-SP) from 1984 to 1987. He was the Budget Director and Chief of Staff of the São Paulo Municipal Planning Secretariat from 1989 to 1992, a member of the Workers Party (PT) Economic Program Coordinating Group in the 1984, 1989 and 1998 Presidential elections, Economic Advisor to President Luiz Inácio Lula da Silva from 1993 to 2002, and one of the Workers Party (PT) Economic Program coordinators in the 2002 Presidential Campaign. Mr. Mantega was also a State Minister of Planning, Budget and Management (named in January 2003 and post held until November 2004) and President of the National Social and Economic Development Bank (BNDES) (named in November 2004 and post held until March 2006.)

J.S. Gabrielli de Azevedo Mr. Gabrielli has been our President since July 22, 2005 and is also a member of the Board of Directors of Petrobras Distribuidora S.A. BR. He is also the President of the Boards of Directors of Petrobras Transporte S.A. TRANSPETRO, Petrobras Química S.A. PETROQUISA, Petrobras Gás S.A. GASPETRO. He was a member of the Board of Directors of Petrobras Energía Participaciones S.A. PEPSA (Directorio) and Petrobras Energía S.A. PESA (Directorio) from March 2003 until August 2005, and Chairman of the boards of these companies from August 2005 until April 2006. He also served as our Chief Financial Officer and Investor Relations Officer (2003-2005). Mr. Gabrielli received a Bachelors degree in Economics from the Federal University of Bahia. He holds a Ph.D. in Economics from Boston University (1987). He served as Dean of the Economic Sciences School of the Federal University of Bahia and Superintendent of the Fundação de Apoio a Pesquisa e Extensão (Foundation for Support of Research and Extension Fapex). He was also a Visiting Researcher at the London School of Economics and Political Science in 2000 and 2001.

Gleuber Vieira Mr. Vieira has been a member of our Board of Directors since January 3, 2003 and is also a member of the Board of Directors of Petrobras Distribuidora S.A. BR. He has been a General in the Brazilian Army since 1987 and in 1995 he became a Four Star General. He served as: Chief of the *Departamento de Ensino e Pesquisa* (Learning and Research Department) of the Brazilian Army (1995-1997); Chief of the Brazilian Army (1999-2002); and Minister of the Army (1999-2002). Mr. Vieira graduated in 1954 in the Artillery Arm from Agulhas Negras Military Academy, and received a Bachelors Degree in Economics from Faculdade de Ciências Econômicas do Rio de Janeiro (currently Universidade Cândido Mendes) in 1965.

Arthur Antonio Sendas Mr. Sendas has been a member of our Board of Directors since March 29, 2004 and is also a member of the Board of Directors of Petrobras Distribuidora S.A. BR. Mr. Sendas is the President of: the *Grupo Sendas*, which ranks as the leader in the retail sector in the state of Rio de Janeiro; the Board of Directors and the Executive Board of Sendas S.A.; Sendas Empreendimentos e Participações Ltda.; Sendas Agropecuária S.A.; the Executive Board of Sendas Comércio Exterior S.A.; the Executive Board of Casa Show S.A.; the Board of Directors of Sendas Distribuidora S.A. Mr. Sendas is also the Vice-President of the Advisory Council of the Brazilian Supermarkets Association Abras and for five years represented the private sector on the National Monetary Council. The Sendas Group, through its various subsidiaries, owns approximately one-half of the supermarket chain under the following four brand names in the State of Rio de Janeiro: Sendas, Pão de Açúcar, Extra and ABC Barateiro; has significant equity stakes in large shopping centers; engages in residential and commercial construction projects and organizes coffee exports to the United States, Europe, Asia and the rest of Latin America, among other activities. Mr. Sendas also sits on the board of directors of Cia. Brasileira de Distribuição Pão de Açúcar, a group that coordinates the supervision of supermarket chains across 12 Brazilian states, and is a member of the Catholic University of Rio de Janeiro s Development Council and President of the Board of Directors of the City of Rio de Janeiro Development Agency Agência Rio.

Roger Agnelli - Mr. Agnelli has been a member of our Board of Directors since April 3, 2006 and is also a member of the Board of Directors of Petrobras Distribuidora S.A. BR. He has been the CEO and President of Companhia Vale

do Rio Doce (CVRD) since July 2001. He was the Chairman of the Board of Directors of CVRD from May 2000 until July 2001. He also was President and CEO of Bradespar S.A. from March 2000 to July 2001.

He joined Bradesco Financial Group in 1981 and stayed until 2001, serving as an Executive Director from 1998 to 2000. He is a former member of the Board of Directors of several major companies in Brazil, such as Companhia Paulista de Força e Luz, Companhia Siderúrgica Nacional, Latas de Alumínio Latasa, VBC Energia, Brasmotor, Mahle Metal Leve, Rio Grande Energia and Serra da Mesa Energia, and was also a Director of UGB Participações and Vice-President of ANBID Brazil s National Association of Investment Banks (1998 2001). He is member of the Brazilian Government Social and Economic Development Council (CDES), the chairman of the China-Brazil Business Council and member of the Board of Directors of Asea BrownBoveri (ABB), of Duke Energy Corporation, and of Suzano Petroquímica. He recently became a member of the International Advisory Committee of the New York Stock Exchange (NYSE). Mr. Agnelli received a degree in Economics from Fundação Armando Álvares Penteado, São Paulo, Brazil in 1981.

Fabio Colletti Barbosa Mr. Barbosa has been a member of our Board of Directors since January 3, 2003 and is also a member of the Board of Directors of Petrobras Distribuidora S.A. BR. He is the Chief Executive Officer of the ABN AMRO Bank Latin America and Chief Executive Officer of the Banco ABN Amro Real S.A. He served as: Chief Executive Officer of ABN Amro Bank/São Paulo (1996-1998); Director of Corporate Banking & Finance of ABN Amro Bank/São Paulo (1995-1996); President of LTCB Latin America Ltda. (1992-1995), the Latin American affiliate of the Long Term Credit Bank of Japan; Corporate Finance Executive Director of Citibank (1986-1992); and member of the Treasury Department of Nestlé (1974-1986). Mr. Barbosa is also a member of the Board of Directors and the Eexecutive Board of the *Federação Brasileira das Associações de Bancos* (Brazilian Bank Associations Federation FEBRABAN), of *Editora Abril* and of the *Conselho de Desenvolvimento Econômico e Social do Governo Federal* (Brazilian Government Social and Economic Development Council). Mr. Barbosa has a Bachelors Degree in Management from Fundação Getúlio Vargas São Paulo (1976) and an MBA from the Institute for Management and Development Lausanne / Switzerland (1979).

Jorge Gerdau Johannpeter Mr. Johannpeter has been a member of our Board of Directors since October 19, 2001 and is also a member of the Board of Directors of Petrobras Distribuidora S.A. - BR. Since 1983, he has been the President of the Gerdau Group, the largest long steel producer in the Americas. Under his leadership, Gerdau became an international company and currently occupies 13th place in the Metal Bulletin ranking of the largest global steelmakers. Mr. Johannpeter also actively participates in efforts to improve the quality of life in the Americas, and especially in Brazil, the country where he lives. He coordinates Ação Empresarial (Business Action), one of the most active movements in Brazil for the implementation of the structural reforms necessary for the country s growth. He is also the leader of the Rio Grande do Sul Quality and Productivity Program, a movement in the area of total quality focused on increasing the efficiency of companies and government entities in Rio Grande do Sul. He is also a member of the National Foundation of Quality (Fundação Nacional da Qualidade FNQ). Mr. Johannpeter also heads the Competitive Brazil Movement, the result of a nation-wide joint effort between companies and the government that seeks to improve competitiveness in the country s public and private sectors. He is the Brazilian representative for the American Society for Quality (ASQ), an entity that seeks to improve business results through the exchange of knowledge. He is on the Board of Directors and Executive Committee of the International Iron and Steel Institute (IISI), on the Board of the Brazilian Steel Institute (IBS), an entity for which he also served as president for two terms, as well as on the Brazilian Economic and Social Development Council.

Directors of PIFCo

PIFCo is managed by a board of directors, consisting of three members, and by its executive officers. The board of directors is responsible for preparing PIFCo s year-end accounts, convening shareholders meetings and reviewing and monitoring its financial performance and strategy. Although not required by PIFCo s memorandum and articles of association, it is PIFCo s policy that the Chairman and all of its executive officers be Petrobras employees.

PIFCo s directors serve indefinite terms and can be removed with or without cause. The following table sets forth certain information about PIFCo s board of directors.

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BOARD OF DIRECTORS OF PIFCo

Name	Date of Birth	Position	Year of Appointment
Daniel Lima de Oliveira	December 29, 1951	Chairman	2005
Marcos Antonio Silva Menezes	March 24, 1952	Director	2003
Nilo Carvalho Vieira Filho	October 26, 1954	Director	2003

Daniel Lima de Oliveira. Mr. Lima de Oliveira has been PIFCo s Chairman and Chief Executive Officer and Petrobras s Executive Manager of Corporate Finance since September 01, 2005. Before, he served as executive officer of PIFCo since April 19, 2000. He joined Petrobras in 1976 as a supply engineer in the Commercial Department. In 1982 he moved to the Financial Department where he worked in the short-term credit division and served as Assistant to the General Manager. From 1984 until 1988, he served as Financial Manager of Petrobras London office. From 1988 to 1992, Mr. Lima de Oliveira served as manager at Braspetro. From 1992 to 1995, he served as Long-Term Credit Division Manager at Petrobras Financial Department. From 1995 to 1999, he served as a financial manager of Petrobras New York office. Since January 2002, he has been a director of Petrobras International Braspetro BV (PIB BV) and Braspetro Oil Services Company BRASOIL and since March 2004 he has been a member of the Board of Directors of REFAP S/A. Mr. Lima de Oliveira graduated in Mechanical Engineering at São José dos Campos s Industrial Engineering School in 1975.

Marcos Antonio Silva Menezes. Mr. Menezes has been PIFCo s Director and Chief Accountant Officer of Petrobras since 1998. He joined Petrobras in 1976 and served as Deputy Superintendent of the former SEFIN Financial Services (1995-1998). He currently serves as a member of the fiscal council and of the Audit Committee of *BRASKEM S.A.* (since 2005), as well as the chairman of the fiscal council of *Instituto Brasileiro de Petróleo e Gás* (since 1998) and *Organização Nacional das Indústrias de Petróleo ONIP* (since 1999). He also served as President of the Fiscal Council of Fundação Petrobras de Seguridade Social PETROS and as a member of the Fiscal Council of Companhia de Gás de Minas Gerais GASMIG . Mr. Menezes is currently a Director of the American Chamber of Commerce AMCHAM/RJ and is a member of *Associação Brasileira das Companhias Abertas* - ABRASCA and its Auditing and Accounting Rules Commission CANC. Mr. Menezes graduated in Accounting (1975) and in Business Management (1977) at Faculdade Moraes Júnior. He has a specialization from Fundação Dom Cabral INSEAD and a post-graduate degree in Financial Management from Fundação Getúlio Vargas.

Nilo Carvalho Vieira Filho. Mr. Vieira has been PIFCo s Executive Manager of Marketing and Trading since June 25, 2004. He joined Petrobras in March 1985 as a Commercialization and Supply Analyst. Since then, he has occupied the positions of supply manager at Petrobras (1990-1994), head of external trading (1995-1998), superintendent of Supply Marketing (98-99), Director of Braspetro (2000-2001) and Director of Eg3 in Argentina (2002-2004). Mr. Vieira graduated in Mechanichal Engineering from the Federal University in Rio de Janeiro in 1978.

Executive Officers of Petrobras

Our board of executive officers, composed of one president and up to six executive officers, is responsible for our day-to-day management. Under our bylaws, the board of directors elects the executive officers, including the president. The president is chosen from among the members of the board of directors. All of the executive officers are Brazilian nationals and reside in Brazil. According to our by-laws the election of officers by the Board of Directors must consider their personal qualification, notorious knowledge and specialization in their respective areas. The maximum term for executive officers is three years, but re-election is permitted. The board of directors may remove any executive officer from office at any time with or without cause. Five of the current executive officers are experienced Petrobras career managers, engineers or technicians.

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The following table sets forth certain information with respect to our executive officers:

EXECUTIVE OFFICERS OF PETROBRAS

Name	Date of Birth	Position	Current Term
J. S. Gabrielli de Azevedo	October 3, 1949	President	April 2008
Almir Guilherme Barbassa	May 19, 1947	Chief Financial Officer and Investor Relations Officer	April 2008
Renato de Souza Duque	September 29, 1955	Manager of Corporate Services	April 2008
Guilherme de Oliveira Estrella	April 18, 1942	Manager of Exploration and Production	April 2008
Paulo Roberto Costa	January 1, 1954	Manager of Refining, Transportation and Marketing	April 2008
Ildo Luís Sauer	September 3, 1954	Manager of Gas and Power	April 2008
Nestor Cuñat Cerveró	August 15, 1951	Manager of International Activities	April 2008

J. S. Gabrielli de Azevedo. Mr. Gabrielli has been our President since July 2005 and a member of our board of directors since July 2005. For biographical information regarding Mr. Gabrielli see Directors and Senior Management of Petrobras Our Board of Directors.

Almir Guilherme Barbassa. Mr. Barbassa has been our Chief Financial Officer and Investor Relations Officer since July 22, 2005. He joined Petrobras in 1974 and worked in several financial and planning capacities, among which the establishment of the first subsidiary of PETROBRAS outside Brazil (in Lybia). From August 1989 to September 1992 he was the Financial Manager of the American subsidiary in Houston, Texas, oversaw the establishment and consolidation of the company, which explores and produces oil and gas, trades oil products and does procurement worldwide. From April 1993 he was the Finance Director of BRASPETRO, the international arm of PETROBRAS. From July 1999 to July 22, 2005 he was PETROBRAS s corporate finance and treasury manager. He is former Chairman of PETROBRAS International Finance Co., PETROBRAS Finance Ltd, and PETROBRAS Netherlands BV, the companies that carry out PETROBRAS s international financial activities. In addition, he was a professor in the economics department of the Petrópolis Catholic University and of the Faculdades Integradas Bennett from 1973 to 1979 and holds a Master s degree in Economics from Getulio Vargas Foundation of Rio de Janeiro.

Renato de Souza Duque. Mr. Duque has been our Executive Director of Services since January 31, 2003. Currently, Mr. Duque was a member of the boards of directors of Petrobras Energía Participaciones S.A., Petrobras Energía S.A. until April, 2006 and he is a member of the board of directors of Petrobras Gás S.A. GASPETRO and Chief Executive Officer of Petrobras Negócios Eletrônicos S.A. With a degree in Electrical Engineering of the Universidade Federal Fluminense and an MBA from the Universidade Federal do Rio de Janeiro, he has been at our company since 1978 as a Petroleum Engineer. He has held several positions including: Manager of E&P Human Resources, Manager of Drilling Operations in the Campos Basin, and Manager of Petrobras Owned Marine Drilling Rigs.

Guilherme de Oliveira Estrella. Mr. Estrella has been our Executive Director of Exploration and Production since January 31, 2003. Currently, Mr. Estrella was a member of the boards of directors and executive boards of Petrobras Energía Participaciones S.A. and Petrobras Energía S.A. until April, 2006 , and also serves as Chairman of the Board of the *Instituto Brasileiro de Petróleo e Gás* (Brazilian Oil and Gas Institute). He worked at our company from 1965 to 1994, when he retired as a geologist of our Exploration Department. Before his retirement, he held several other positions, including: General Superintendent (1989-1993); Superintendent of Research and Development for exploration, drilling and production (1985-1989); Head of the Exploration Division (1981-1985); Head of the Organic

Geochemistry Sector (1981); Head of the Brazilian East Coast Basin Interpretation Sector of our Exploration Department DEPEX/RJ (1978-1981); and Exploration Manager of

Petrobras Internacional S.A. BRASPETRO for Iraq (1976-1978). Mr. Estrella has also served as director of the *Instituto Brasileiro de Petróleo e Gás*. Mr. Estrella graduated in 1966, from the Universidade Federal do Rio de Janeiro s School of Geology.

Paulo Roberto Costa. Mr. Paulo Roberto has been our Executive Director of Refining, Transportation and Marketing since May 14, 2004. From 1979 to 1994 he worked on platform installation and production development at the Campos basin in the areas of Engineering, Support Management and as Superintendent of the Southeastern Production Region. In 1995 he was promoted to General Manager of the Southern Brazil Exploration and Production, or E&P, with responsibility for the Santos and Pelotas basins. In 1996 he became general manager for Logistics in the E&P area. From May 1997 to 1999 he headed up the Gas Segment, responsible for commercialization of natural gas. He was Director of Petrobras Gas S.A.-Gaspetro from May 1999 to December 2000. From January 2001 to April 2003, he was General Manager for Logistics at Petrobras of Natural Gas Segment. He has been Managing Director of TBG-Transportadora Brasileira Gasoduto Bolívia-Brasil since April 2003. In May 14, 2004 he was appointed Downstream Director of Petróleo Brasileiro S.A. Petrobras. Mr. Paulo Roberto graduated in Mechanical Engineering from the Federal University of Paraná in 1976.

Ildo Luis Sauer. Mr. Sauer has been our Executive Director of Gas and Energy since January 31, 2003 and was a member of the board of Petrobras Energía Participaciones S.A. and Petrobras Energía S.A until April, 2006 . He also served as consultant at TecSauer Consultoria Ltda. and as manager of the nuclear reactor project for the Brazilian Navy. He holds a Ph.D. in nuclear engineering from the Massachusetts Institute of Technology. He also holds a MSc degree from COPPE Federal University of Rio de Janeiro in Energy Planning/Nuclear Power. He is Professor at the Instituto de Eletrotécnica e Energía da Universidade de São Paulo (Electrotechnical and Energy Institute of the University of São Paulo), on leave, where he has published more than 100 technical papers and supervised more than 40 doctoral and master theses in the field.

Nestor Cuñat Cerveró. Mr. Cerveró has been our Executive Director of International Activities since January 31, 2003 and was a member of the boards of directors of Petrobras Energía Participaciones S.A. and Petrobras Energía S.A until April, 2006 . He has been with Petrobras since 1975, holding several positions including: Energy Manager, *Programa de Termelétricas* (Gas-Fired Power Plants Program); Gas-Fired Power Plants Manager of the Participations Superintendency; assistant to the CEO for the development of new ventures and partnerships; and Head of the Energy Sector of our industrial area. He has also represented our company at the boards of directors of several gas-fired energy companies and acted as assistant to the *Presidência da Comercializadora Brasileira de Energía Emergencial* (Presidency of the Brazilian Supplier of Emergencial Energy CBEE) of the Ministry of Mines and Energy. Mr. Cerveró received a degree in Chemical Engineering from the Federal University of Rio de Janeiro, and received graduate education in Processing Engineering at Petrobras, and an MBA (Executive Management) from Fundação Getúlio Vargas FGV.

Executive Officers of PIFCo

All of the current executive officers are experienced managers from Petrobras, some of whom have served on the boards of directors of Petrobras subsidiaries and in representative offices abroad. The executive officers work as a board and are responsible for PIFCo s day-to-day management. PIFCo s executive officers serve indefinite terms and can be removed with or without cause.

The following table sets forth certain information about PIFCo s executive officers.

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EXECUTIVE OFFICERS OF PIFCo

Name	Date of Birth	Position	Year of Appointment
Daniel Lima de Oliveira	December 29, 1951	Chairman	2005
Guilherme Pontes Galvão França	January 18, 1959	Commercial Manager	2005
Sérvio Túlio da Rosa Tinoco	June 21, 1955	Financial Manager	2005
Mariângela Monteiro Tizatto	August 9, 1960	Accounting Manager	1998
Nilton Antônio de Almeida Maia	June 21, 1957	Legal Manager	2000
Gérson Luiz Gonçalves	September 29, 1953	Auditor Manager	2000
Isabela Cesário de Faria Alvim	July 11, 1961	Secretary	2004

Daniel Lima de Oliveira Mr. Lima de Oliveira has been PIFCo s Chairman and Chief Executive Officer and Petrobras s Executive Manager of Corporate Finance since September 01, 2005. For biographical information regarding Mr. Lima de Oliveira see Directors and Senior Management of Petrobras Board of Directors of PIFCo.

Guilherme Pontes Galvão França. Mr. França became an executive officer of PIFCo on March 7, 2005. He has been General Manager of Petroleum and Industrial Products Supply and Trading since October 1, 2005. He joined Petrobras in 1982 and worked as a Commercialization and Supply Analyst in the logistics area of Petrobras from 1982 to 1990. In 1990 he moved to the trading area specializing in Lubricants and fuel oil. From 1993 to 2000, Mr. França served as Manager of Special Products Domestic Sales. From 2001 to 2004, he served as Manager of LPG Trading and Domestic Sales and Manager of Clean Products Supply and Trading in 2005. Mr. França graduated in Chemical Engineering from the Federal University of Rio de Janeiro in 1981.

Sérvio Túlio da Rosa Tinoco. Mr. Tinoco became an executive officer of PIFCo on September 01, 2005. Mr. Tinoco is the financial manager of PIFCo. He joined Petrobras in 1993 as an Economist in the Financial Department. Since 2000, he has served as Manager of Corporate Financing Division. From 1996 to 1999 he served as Manager of Trade Finance, Guarantees and Foreign Exchange Transactions. From 1995 to 1996 he served as Manager of Credit and Collection. From 1999 to 2000, he served as a financial manager of Petrobras New York office. Mr. Tinoco holds a bachelor degree in Economics from Universidade Oswaldo Cruz, São Paulo in 1978 and had a MBA from Fundação Getúlio Vargas, São Paulo in 1983 partially completed with a one year in Institut Supérieur des Affaires ISA/HEC France.

Mariângela Monteiro Tizatto. Ms. Tizatto has served as PIFCo s Accounting Manager since April 4, 1998. She joined Petrobras in 1989 as an accountant in the Accounting Department. Since 1999, she has served as Petrobras General Manager for Accounting Operations. From 1990 to 1995, she was Manager of Petrobras Consolidated Accounting System, and from 1995 to 1999, she served as Manager of Petrobras Division of Corporate Accounting. Before joining Petrobras, Ms. Tizatto was Manager of Auditing for Deloitte Touche Tohmatsu, where she worked for seven years. Ms. Tizatto has a Bachelors degree in Accounting from the Cândido Mendes University and an Executive MBA from COPPEAD Universidade Federal do Rio de Janeiro. She was also a professor of Advanced Accounting at the Moraes Junior University in Rio de Janeiro (1990). Ms. Tizatto was a Fiscal Council member of Companhia Potiguar de Gás POTIGAS, during 2003 and 2004; Petrobras Gás S/A GASPETRO during 2005; and a Fiscal Counsel alternate for Fundação Petrobras de Seguridade Social PETROS (Petrobras Pension Fund) during 2003 and 2004. She is a Fiscal Council member of Petrobras Distribuidora S.A. BR and since 1995 she has been member of the Comissão de Auditoria e Normas Contábeis da ABRASCA Associação Brasileira das Companhias Abertas.

Nilton Antônio de Almeida Maia. Mr. Maia has served as PIFCo s Legal Manager since April 19, 2000. He joined Petrobras in 1984 as an internal auditor. He has served as a tax consultant to Petrobras Legal Department, and since early 2000, has served as General Manager for the Finance and Tax Division. Mr. Maia also currently serves as General Counsel for Petrobras. He has completed post-graduate degrees in law, with specializations in energy and tax law, from the Universidade Cândido Mendes and the Universidade Estácio de Sá.

Gerson Luiz Gonçalves. Mr. Gonçalves has served as PIFCo s Auditor Manager since April 19, 2000. He joined the Internal Audit Department of Petrobras in 1976 and has been Petrobras Executive Manager for Internal

Auditing for the last six years. He is responsible for all of Petrobras internal accounting control activities. Mr. Gonçalves is a member of the Brazilian Institute of Internal Auditors (AUDIBRA) and of the United States Institute of Internal Auditors (IIA). He received a Bachelor s degree in Accounting from Universidade de São Paulo USP in 1975.

Isabela Cesário de Faria Alvim. Ms. Alvim holds a bachelor degree in Economics from Pontifícia Universidade Católica do Rio de Janeiro, Brazil, Post Graduation in Shipping from Federal University of Rio de Janeiro and MBA from Instituto Brasileiro de Mercado de Capitais (IBMEC). Ms. Alvim has served as PIFCo s Secretary since April 2004. She joined Petrobras in 1984 as an analyst for Maritime Transport. In 1995 she moved from the Planning Department to the Financial Department. Ms. Alvim has served as Manager of Trade Lines, Guarantees and Structured Finance since 2001. She has been Subsidiaries Manager since April 2004.

Compensation

Petrobras

For 2005, the aggregate amount of compensation we paid to all members of the board of directors and executive officers was approximately U.S.$3 million.

In addition, the members of the board and the executive officers receive certain additional benefits generally provided to our employees and their families, such as medical assistance, payment of educational expenses and supplementary social security benefits.

We have no service contracts with our directors providing for benefits upon termination of employment. We have a compensation and succession committee in the form of an advisory committee. See Advisory Committees Petrobras.

PIFCo

PIFCo s directors and executive officers are paid by Petrobras in respect of their function as Petrobras employees, but they do not receive any additional compensation, pension or other benefits from PIFCo or Petrobras in respect of their functions as PIFCo s directors or officers, as the case may be.

Indemnification of Officers and Directors

Our bylaws require us to defend our senior management in administrative and legal proceedings and to maintain insurance coverage to protect senior management from liability arising from the performance of their functions. Subject to certain limitations, the policy reimburses losses and expenses due to wrongful acts of our directors and officers, such as breach of duty, neglect, error, misstatement, misleading statements, omission or acts by our directors and officers in the performance of their position, or any matter claimed against them solely by reason of their functions or positions, including the purchase or sale of our securities. Coverage includes the advancement of defense costs.

Share Ownership

Petrobras

As of May 31, 2006, the members of our board of directors, our executive officers, the members of our fiscal council, and close members of their families, as a group, beneficially held a total of 9,907 common shares and 26,928 preferred shares of our company. Accordingly, on an individual basis, and as a group, our directors, executive officers, fiscal council members, and close members of their families beneficially owned less than one percent of any class of our shares. The shares held by our directors, executive officers, fiscal council members, and close members of their families have the same voting rights as the shares of the same type and class that are held by our other shareholders. None of our directors, executive officers, fiscal council members, or close members of their

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families holds any options to purchase common shares or preferred shares. Petrobras does not have a stock option plan for its directors, officers and employees.

PIFCo

As of December 31, 2005, PIFCo s share capital was composed of 50,000 shares of common stock. All of PIFCo s issued and outstanding shares of common stock are owned by us.

Fiscal Council

We have established a permanent fiscal council (*conselho fiscal)* in accordance with applicable provisions of the Brazilian Corporate Law, composed of up to five members. As required by the Brazilian Corporation Law our fiscal council is independent of our management and external auditors. The fiscal council s responsibilities include, among others: (i) monitoring management s activities and (ii) reviewing our annual report and financial statements. The members and their respective alternates are elected by the shareholders at the annual general shareholder s meeting. Holders of preferred shares without voting rights and minority common shareholders are each entitled, as a class, to elect one member and his respective alternate to the fiscal council. The Brazilian government has the right to appoint the majority of the members of the fiscal council and their alternates. One of these members and his respective alternate are appointed by the Minister of Finance representing the Brazilian Treasury. The members of the fiscal council are elected at our annual general shareholders meeting for a one-year term and reelection is permitted.

The following table lists the current members of the fiscal council:

FISCAL COUNCIL

Name	Year of First Appointment
Marcus Pereira Aucélio	2005
Erenice Alves Guerra	2006
Túlio Luiz Zamin	2003
Nelson Rocha Augusto	2003
Maria Lúcia de Oliveira Falcón	2003

The following table lists the alternate members of the fiscal council:

Name	Year of First Appointment
Eduardo Coutinho Guerra	2005
Marcelo Cruz	2006
Edison Freitas de Oliveira	2002
Maria Auxiliadora Alves da Silva	2003
Celso Barreto Neto	2002

Audit Committee

Petrobras

We have an audit committee that advises our board of directors composed exclusively of members of our board of directors.

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On June 17, 2005, our Board of Directors approved the appointment of our audit committee to satisfy the audit committee requirements of the Sarbanes-Oxley Act of 2002 and Rule 10A-3 under the Securities Exchange Act of 1934.

The audit committee is responsible for, among other things: (1) making recommendations to our Board of Directors with respect to the appointment, compensation and retention of our independent auditor; (2) assisting in the resolution of conflicts between management and the independent auditor with respect to our financial statements; and (3) establishing procedures for the receipt, retention and treatment of complaints regarding accounting, internal control and auditing matters, including procedures for the confidential, anonymous submission by employees of concerns regarding questionable accounting or auditing matters. The current members of our audit committee are Fabio Colletti Barbosa and Gleuber Vieira. Jaques Wagner was a member of our audit committee until April 3, 2006. There is an opening for a third member in our audit committee and we are currently in the process of selecting such third member. All our audit committee members are independent as defined in 17 CRF 240.10A-3.On December 16, 2005, our audit committee s charter was amended to meet the audit committee requirements of the Sarbanes-Oxley Act of 2002 and Rule 10A-3 under the Securities Exchange Act of 1934, including the incorporation of the powers mentioned above.

Other Advisory Committees

The bylaws of Petrobras also provide for the creation of a *Comitê de Remuneração e Sucessão* (compensation and succession committee), and a *Comitê de Meio Ambiente* (environmental committee).

PIFCo

PIFCo does not have any committees to its board of directors.

Employees and Labor Relations

Petrobras

We had 53,904 employees on December 31, 2005, compared to 52,037 employees on December 31, 2004 and 48,798 on December 31, 2003. The increase in the number of our employees in 2005 is primarily a result of the implementation of a hiring policy designed to meet our demand for more employees. This increased demand has resulted from the growth of our business and our desire to reduce the number of outsourced personnel. Expenses relating to employees of the parent company amounted to approximately R$4,166 million (U.S.$1,711 million) in 2005, R$3,546 million (U.S.$1,212 million) in 2004 and R$3,612 million (U.S.$1,175 million) in 2003. During 2005, these expenses represented 67% of our consolidated employee expenses.

Of the 53,904 employees of Petrobras on December 31, 2005, the parent company employed 40,541. Of these 40,541 employees, 28,070 occupied mid-level positions related to operations and administrative support, and 11,561 worked as upper-level employees in engineering and administration. The remaining 910 employees of the parent company were maritime employees. 68% of the parent company s workforce was located in the Southeast region of Brazil, 26% was located in the Northeast region, and the remaining 6% was elsewhere.

We negotiate annually collective bargaining agreements with the Oil Workers Unified Federation, the union to which our onshore employees are affiliated, and the Maritime Employee s Union, the union to which our maritime employees are affiliated. The current collective bargaining agreement with the Oil Workers Unified Federation was signed on December 6, 2005, and is retroactive to September 1, 2005. The economic clauses of this collective bargaining agreement will expire on August 31, 2006. The collective bargaining agreement with the maritime employees union was signed on March 31, 2006 and is retroactive to November 1, 2005. This collective bargaining agreement will expire on October 31, 2006.

Under the terms of the new collective bargaining agreements for our onshore employees, we agreed to increase the salary of oil workers by 6.02% and grant a single level pay scale raise to all employees, effective retroactively to September 1, 2005, respectively.

We consider our relations with our employees and with the Oil Worker s Unified Federation and maritime employee s union to be good and respectable.

A labor strike has not caused a material decrease in production since 1995, when our oil workers held a 30-day strike to protest the amendment to the Brazilian constitution under which we ceased to be the Brazilian government s exclusive agent in the Brazilian hydrocarbon industry. The strike caused a significant decrease in our production and refining output and led to a substantial increase in the level of our imports. Since then, the most significant strike occurred in 2001, when our oil workers were on strike for five days.

We spent approximately R$311.9 million (U.S.$128.1 million) on employee training in 2005 at our training centers, as compared to R$274.7 million (U.S.$93.9 million) in 2004.

With the enactment of the Oil Law and the emergence of competitors in the Brazilian oil sector, we have developed a strategic plan to provide incentives to attract new employees and to retain existing ones. As part of our employee incentives, we have merit-based promotions and, as permitted by Brazilian law, a profit sharing plan with predetermined criteria. Pursuant to this plan, the amount of the profit sharing is determined by our Board of Directors and the manner of distribution is determined by negotiation with the labor unions representing our employees. However, under Brazilian law, the profit sharing plan will be subject to an annual limit equal to 25% of total proposed dividends for the year.

Our profit sharing distributions to our employees within the entire Petrobras Group were R$1,006 million (U.S.$430 million) for 2005, R$783 million (U.S.$295 million) for 2004 and R$894 million (U.S.$291 million) for 2003. At Petrobras annual general shareholders meeting held on April 3, 2006, its shareholders approved a profit sharing distribution to Petrobras employees (excluding subsidiaries) of R$846 million (U.S.$361 million) for 2005. Our subsidiaries approved a total profit sharing distribution to their employees of R$160 million (U.S.$69 million) at their annual general shareholders meetings in March of 2006.

Our Pension and Health Care Plans

We sponsor a contributory defined benefit pension plan known as PETROS, which covers approximately 60.7% of our employees. The principal objective of PETROS has been to supplement the social security pension benefits of our employees, as well as employees of our Brazilian subsidiaries and affiliates, certain other companies and PETROS itself. Employees that participate make mandatory monthly contributions. Our historical funding policy has been to make annual contributions to the plan in the amount determined by actuarial appraisals. Contributions are intended to provide not only for benefits attributed to service to date but also for those expected to be earned in the future. We made contributions of U.S.$570 million in 2005, as compared to contributions of U.S.$435 million in 2004. We recorded a liability of U.S.$3,833 million in 2005, U.S.$3,081 million in 2004 and U.S.$2,055 million in 2003 for the excess of the actuarial value of our obligation to provide future benefits over the fair value of the plan assets used to satisfy that obligation. See Note 18 to our audited consolidated financial statements.

In addition, some of our consolidated subsidiaries, including PEPSA and Liquigás, have their own defined benefit plans.

Since the PETROS plan is not admitting new participants since August 9, 2002, employees hired since that date are covered by specific insurance policies, and will continue to be covered by such policies until we are able to offer them a supplemental pension plan.

In 2003, we formed a task force with representatives of the National Union of Oil Workers (FUP) and with PETROS, among others, in order to evaluate alternatives to a new model for the our supplementary pension plan, including analyses of negotiated arrangements for the settlement of actuarial deficits.

We have worked to develop proposals with the petroleum union and others representatives, in order to evaluate alternatives for a new model for our supplementary pension plan. We held meetings with these entities to consider questions relative to the Petros Plan and when the proposal for a new plan will be completed. One of the

principal objectives of the negotiations was to define a solution to the technical deficit of the Petros Plan and also to solve the problems of structural and diagnostic issues raised in the FUP and union studies, while always complying with the limits imposed Brazilian law.

On April 19, 2006 PETROBRAS Executive Board has made a proposal to the labor union representatives of a New Pension Plan. The proposed New Supplementary Pension Plan is based on the variable contribution model, with the capitalization of funds through individual accounts. Retirement pensions are established as a function of the balance in the account in addition to providing coverage for social security risks (disability and death during active employment) and options for payment of lifetime benefits, with a provision for transferring certain pension rights to dependents upon the death of the principal member, or in accordance with a fixed term system.

According to SFAS No. 87 Employers Accounting for Pensions (SFAS 87) the new plan is considered a defined-benefit pension plan and the liability related to futures benefits will be calculated on an annual basis by an independent actuary and will be recorded as component of the sponsor companies liabilities.

This proposal is in the process of being submitted to participants and still requires approval by the Board of Directors which will only consider it if the adherence rate represents a substantial majority of participants.

We maintain a health care benefit plan (AMS), which offers defined benefits and covers all employees (active and inactive) together with their dependents. We manage the plan, with the employees contributing fixed amounts to cover principal risks and a portion of the costs relating to other types of coverage in accordance with participation tables defined by certain parameters, including salary levels.

Our commitment related to future benefits to plan participants is calculated on an annual basis by an independent actuary, based on the Projected Unit Credit method. The health care plan is not funded or otherwise collateralized by assets. Instead, we make benefit payments based on annual costs incurred by plan participants.

The actuarial gains and losses arising from the differences between the actuarial assumptions and the costs effectively incurred are respectively included or excluded when defining the net actuarial liability. These gains and losses are amortized over the average remaining service period of the active employees. In 2005, we have revised some of these actuarial assumptions. See Item 5. Operating and Financial Review and Prospects Critical Accounting Policies and Estimates Pension and Other Post-Retirement Benefits

PIFCo

With the exception of twenty-one employees of PEL, PIFCo s personnel consist solely of Petrobras employees, and PIFCo relies on Petrobras to provide all administrative functions.

ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

Major Shareholders

Petrobras

Our capital stock is composed of common shares and preferred shares, all without par value. On May 31, 2006, there were 2,536,673,672 outstanding common shares and 1,849,478,028 outstanding preferred shares.

On July 22, 2005, our shareholders approved a resolution to split each share of our capital stock into four shares. As a result of the stock split, the ratio of our common and preferred shares ADRs changed to four shares to one ADR. The stock split and change of ADR ratio became effective on September 1, 2005.

Under the Brazilian Corporation Law, as amended, the number of non-voting shares of our company may not exceed two-thirds of the total number of shares. The Brazilian government is required by law to own at least a majority of our voting stock and currently owns 55.7% of our common shares, which are our only voting shares. The

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Brazilian government does not have any special voting rights, other than the right to always elect a majority of our directors, irrespective of the rights our minority shareholders may have to elect directors, set forth in our by-laws.

The following table sets forth information concerning the ownership of our common shares and preferred shares as of May 31, 2006 by the Brazilian government, certain public sector entities and our officers and directors as a group. We are not aware of any other shareholder owning more than 5% of our common shares.

Shareholder	Common Shares	%	Preferred Shares	%	Total Shares	%
Brazilian government	1,413,258,228	55.7			1,413,258,228	32.2
BNDES Participações S.A.-BNDESPAR	47,246,164	1.9	287,023,667	15.5	334,269,831	7.6
Other Brazilian public sector entities	1.812.625	0.1	778.908	0.1	2.591.533	0.1
All directors and executive officers as a Group (15 persons)	9,907		26,928		36,835	
Others	1.074.346.748	42.3	1.561.648.525	84.4	2.635.995.273	60.1
Total	2,536,673,672	100%	1,849,478,028	100%	4,386,151,700	100%

In August 2000, the Brazilian government sold 180,609,768 of our common shares, reducing its percentage of ownership of our common shares from 84% to the current preferred 55.7%. In July 2001, BNDES sold 41,381,826 of our preferred shares, which constituted its entire holdings of our preferred shares. As of May 31, 2006, approximately 37.1% of our preferred shares and approximately 27.2% of our common shares were held of record in the United States directly or in the form of American Depositary Shares. As of May 31, 2006, we had approximately 171.670.784 record holders of preferred shares, or American Depositary Shares representing preferred shares, and approximately 172.533.688 record holders of common shares, or American Depositary Shares representing common shares, in the United States. The ratio of our common and preferred share ADRs is four shares to one ADR. This ratio was changed by the stock split effective September 1, 2005.

PIFCo

As of December 31, 2005, PIFCo s capital stock was composed of 50,000 shares of common stock. All of PIFCo s issued and outstanding shares are owned by us.

Petrobras Related Party Transactions

Board of Directors

Direct transactions with interested members of our board of directors or our executive officers require the approval of our board of directors. None of the members of our board of directors, our executive officers or close members of their families has had any direct interest in any transaction we effected which is or was unusual in its nature or conditions or material to our business during the current or the three immediately preceding financial years or during any earlier financial year, which transaction remains in any way outstanding or unperformed. In addition, we have not entered into any transaction with related parties which is or was unusual in its nature or conditions during the current or the three immediately preceding financial years, nor is any such transaction proposed, that is or would be material to our business.

We have no outstanding loans or guarantees to the members of our board of directors, our executive officers or any close member of their families.

For a description of the shares beneficially held by the members of our board of directors and close members of their families, see Item 6. Directors, Senior Management and Employees Share Ownership.

Brazilian Government and PETROS

We engage in numerous transactions in the ordinary course of business with our controlling shareholder, the Brazilian government, and with other companies controlled by it, including financings from BNDES and banking, asset management and other transactions with Banco do Brasil S.A.

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The above-mentioned transactions with Banco do Brasil had a net amount of U.S.$5,888 million as of December 31, 2005.

As of December 31, 2005, we recorded transactions with the Brazilian government and other subsidiaries controlled by it relating to accounts receivable due to oil products supply through our consolidated subsidiary BR Distribuidora in the total amount of U.S.$684 million.

As of December 31, 2005, we had a receivable (the Petroleum and Alcohol Account) from the Brazilian government, our controlling shareholder, of U.S.$329 million secured by a U.S.$53 million blocked deposit account. See Item 4. Regulation of the Oil and Gas Industry in Brazil The Petroleum and Alcohol Account.

We also have restricted deposits made by us, which serve as collateral for legal proceedings involving the Brazilian government. As of December 31, 2005, these deposits amounted to U.S.$775 million.

Additionally, according to Brazilian law, we are only permitted to invest in securities issued by the Brazilian Government in Brazil. This restriction does not apply to investment outside of Brazil. As of December 31, 2005, the value of these government securities that has been directly acquired and held by us amounted to U.S.$269 million.

We also have accounted for related party transactions with PETROS, basically composed of government securities advanced by us to compose the plans assets. As of December 31, 2005, the value of these securities amounted to U.S.$362 million. In addition, PETROS also makes direct investments in government securities.

For additional information regarding our principal transactions with related parties, see Note 26 to our audited consolidated financial statements.

PIFCo Related Party Transactions

As a result of being our wholly-owned subsidiary, PIFCo has numerous transactions with us and other affiliated companies in the ordinary course of business. PIFCo s primary business is to serve as an intermediary between third-party oil suppliers and us by engaging in crude oil and oil product purchases from international suppliers and reselling crude oil and oil products in U.S. dollars to us on a deferred payment basis, at a price which represents a premium to compensate PIFCo for its financing costs. Substantially all of PIFCo s revenues are generated by transactions with us.

Since PIFCo s inception there have been no, and there are no proposed, material transactions with any of PIFCo s officers and directors. PIFCo does not extend any loans to its officers and directors.

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PIFCo s transactions with related parties resulted in the following balances in 2005 and 2004:

	December 31, 2005		December 31, 2004	
	Assets	Liabilities	Assets	Liabilities
	(in millions of U.S. dollars)			
Assets				
Current				
Accounts receivable	8,681.1		7,788.1	
Notes receivable(1)	3,329.3		1,598.5	
Marketable Securities				
Exports Prepayment	414.5		152.9	
Others	1.5			
Other non current				
Marketable securities	2,165.7		1,814.9	
Notes receivable	580.0		338.4	
Exports prepayment	529.4		1,261.8	
Liabilities				
Current				
Trade accounts Payable		950.7		562.1
Notes payable(1)		4,346.1		2,881.5
Unearned income		176.5		131.3
Long-term liabilities				
Notes payable (1)		3,734.1		3,553.5
Total	15,701.5	9,207.4	12,954.6	7,128.4
Current	12,426.4	5,473.3	9,539.5	3,574.9
Long-term	3,275.1	3,734.1	3,415.1	3,553.5

(1) PIFCo s notes receivable from and payable to Petrobras bear interest at LIBOR plus 3.0% per year.

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PIFCo s principal transactions with related parties are as follows:

	Year ended December 31,					
	2005		2004		2003	
			(in millions of U.S. dollars)			
	Income	Expense	Income	Expense	Income	Expense
Sales of crude oil and oil products and services						
PETROBRAS	7,025.7		6,374.3		3,618.8	
REFAP S.A.	1,405.1		972.1		794.3	
Petrobras America, Inc. PAI	5,487.9		2,734.5		1,109.9	
BR Distribuidora	1.8		3.5		4.3	
EG3 S.A.			12.9		10.0	
PESA	49.5		21.1		5.8	
Petrobras Bolívia	4.4					
Cost of sales						
PETROBRAS		(5,931.6)		(3,236.7)		(1,670.0)
Petrobras America, Inc. PAI		(459.4)		(375.3)		(767.9)
Braspetro Oil Services Company BRASOIL				(74.7)		(87.6)
Companhia MEGA S.A.		(367.5)		(299.4)		(235.9)
Eg3 S.A.				(60.4)		(74.5)
PESA		(187.8)		(72.1)		
PIB.B.V.		(152.0)		(158.3)		
PEBIS		(164.3)		(110.3)		
REFAP		(109.9)		(4.1)		
Ecuadortlc S.A.		(211.8)				
Petrobras Colômbia		(196.0)				
Others						(15.5)
Selling, general and administrative expense						
PETROBRAS		(158.0)		(97.0)		(17.1)
Others		(0.1)		(1.7)		
Financial income						
PETROBRAS	580.9		466.1		313.7	
REFAP S.A.	24.2		16.8		8.8	
Braspetro Oil Company BOC	15.6		11.0		14.4	
Braspetro Oil Services Company BRASOIL	11.5		15.4		9.4	
PIB.B.V.	82.8		56.7		51.5	
Marlim			1.8		3.3	
Others	50.5		0.8		0.6	
Financial expense						
PETROBRAS		(409.5)		(168.4)		(111.0)
Others		(0.3)		(0.6)		(0.9)
Other Income and Expense						
PNBV				(0.5)		

Total	14,739.9	(8,348.2)	10,687.0	(4,659.5)	5,944.8	(2,980.4)

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ITEM 8. FINANCIAL INFORMATION

Petrobras Consolidated Statements and Other Financial Information

See Item 18. Financial Statements and Index to Financial Statements.

PIFCo Consolidated Statements and Other Financial Information

See Item 18. Financial Statements and Index to Financial Statements.

Legal Proceedings

Petrobras

We are currently subject to numerous proceedings relating to civil, criminal, administrative, environmental, labor and tax claims. Several individual disputes account for a significant part of the total amount of claims against us. Our audited consolidated financial statements only include provisions for probable and reasonably estimable losses and expenses we may incur in connection with pending litigation, including the proceedings described below under Environmental Claims. See Note 21 to our audited consolidated financial statements. The table below sets forth our recorded financial provisions by type of claim:

PROVISIONS BY TYPE OF CLAIM(1)

	As of December 31,	
	2005	2004
	(in millions of U.S. dollars)	
Labor claims	7	26
Tax claims	87	73
Civil claims	79	123
Commercial claims and other contingencies	62	35
Total	235	257

(1) Excludes provisions for contractual contingencies and tax assessments by the INSS.

Claims against Petrobras, the parent company, which as of December 31, 2005, corresponded to approximately 40.4% of the total amount of claims against us, have decreased and the amounts paid by us in respect of legal claims against Petrobras in the last five years averaged U.S.$58 million per year. As of December 31, 2005, we estimated that the total amount of claims against us, excluding disputes involving non-monetary claims or claims not easily evaluated in the current stage of the proceedings, was approximately U.S.$8.1 billion.

The most significant claims are described below:

Civil claims

On November 23, 1992, Porto Seguro Imóveis Ltda., a minority shareholder of Petroquisa, filed a lawsuit against us for alleged losses suffered as a result of the sale of the share participation held by Petroquisa in various petrochemical companies included in the National Privatization Program (*Programa Nacional de Desestatização*). The plaintiff in the lawsuit requests that we, as controlling shareholder of Petroquisa, be compelled to reinstate the damages made to Petroquisa s equity, as a consequence of the corporate acts that approved the minimum sales price attributed to its share participation in the capital of the privatized companies. An initial decision on January 14, 1997 held us liable to Petroquisa for damages in an amount equivalent to U.S.$3,406 million. Additionally, we were required to pay the plaintiff 5% of the indemnification amount as a premium as well as lawyers fees of 20% over

that amount. However, since the amount due is payable to Petroquisa, not the plaintiff, and we own 99.0% of Petroquisa s share capital, the actual disbursement, in case the decision is not dismissed, will be limited to such 25% of the damages amount, or U.S.$851 million. We appealed and prevailed in canceling the judgment, but a subsequent appellate decision on March 30, 2004 found us liable for U.S.$2,359 million, plus a 5% premium and 20% of attorney s fees, the latter in favor of Porto Seguro. -Further, we filed appeals to both the Superior Justice Tribunal and to the Federal Supreme Court, and we are waiting for a final decision on these appeals.

On May 28, 1981, Kallium Mineração S.A. brought an action against Companhia de Pesquisa de Recursos Minerais CPRM seeking an indemnification of approximately U.S.$450 million for the early termination of a contract for the exploration of a potassium salt mine in Sergipe. The Brazilian Government, which had previously granted CPRM the right to develop a exploration project for the potassium salt mine, cancelled the concession to CPRM and transferred it to our former subsidiary, Petromisa. CPRM, on its turn, terminated its contract for the exploration of the mine with Kallium Mineração S.A. As a result, CPRM brought us and the Brazilian Government into the proceedings as co-defendants. On August 10, 1999, the court denied most of Kallium s claims, but required us to indemnify all expenses incurred by Kallium for research conducted in connection with the exploration of the mine, which correspond to approximately U.S.$ 1 million. In September 1999, Kallium and we appealed the decision and both appeals were denied. We have filed additional appeals and are awaiting a judgment. The total damages amount that may be payable will be subject to monetary adjustment and to interest at 6% calculated as of the date of the filing of the lawsuit

Several individuals have filed a lawsuit (an *ação popular*) against us, Repsol-YPF and the Brazilian government seeking to unwind the 2001 exchange of certain of our operating assets in Brazil for some of YPF s operating assets in Argentina. The plaintiffs maintain that the assets exchanged were not properly valued and that, therefore, the transaction was not in our best interests. On September 5, 2002, the court granted an injunction to the plaintiffs. The Superior Court of Justice of Brazil suspended the injunction, stressing that the transaction had been approved by the Brazilian antitrust authorities, the ANP and the Brazilian Federal Audit Court. On May 15, 2005, the lawsuit was judged on the merits in our favor and the other parties appealed. We are awaiting a final disposition on the merits.

On March 9, 2006, Barracuda Caratinga Leasing Company B.V. (BCLC), the special purpose company that currently owns the assets of the project, represented by Petrobras (as Construction and Operations Manager), commenced an arbitration against KBR pursuant to the provisions of the EPC Contract as amended between BCLC and KBR. BCLC is seeking damages in the amount of approximately U.S.$220 million plus interest for the costs of monitoring and replacing defective stud bolts, plus the costs and expenses of the arbitration. On March 17, 2006, KBR responded with its counter-notice seeking dismissal of BCLC s claim and approximately U.S.$22 million in damages for replacement costs of stud bolts that were replaced by KBR. The parties are proceeding to arbitration. Each party has chosen its party-appointed arbitrator, a third arbitrator will be selected and the proceedings will commence in due course.

On January 18, 2000, a pipeline connecting one of our terminals to a refinery in Guanabara Bay ruptured, causing a release of approximately 341,000 gallons of crude oil into the bay. We undertook action to control the spill in an effort to prevent the oil from threatening additional areas. As a result of this spill, several individual damage lawsuits were filed by fishermen of the State of Rio de Janeiro. The lawsuits currently in course correspond to an aggregate amount of approximately R$52 million. In addition, the Federation of Fishermen of the State of Rio de Janeiro filed a lawsuit against us claiming damages of approximately R$537 million. On February 7, 2002, the judge hearing this matter found that damages were due, but not in the amount claimed. Both parties appealed this decision. On October 8, 2002, the Court of Appeals of the State of Rio de Janeiro denied the appeal filed by the plaintiff and dismissed the claim with respect to all fishermen who had already settled their claims against us or who had already filed individual lawsuits against us, and also with respect to certain other fishermen. These dismissals dramatically reduced the number of plaintiffs who could be entitled to damages. We have filed additional appeals and all of them were denied. A report was issued by an expert of the Court of Appeals and we have already contested it. Court experts are currently evaluating the damages caused.

In November 2005, two employees from Finarge Armamento Genoveses S.r.I., an Italian company that renders transportation services to our Company, filed a lawsuit against us in Genova courts, requesting indemnification for

rescuing an adrift platform. Such lawsuit is based on Sections 2, 3 and 10 of the Brussels

Convention, which provides that those who assist adrift vessels are entitled to an indemnification. The amount of the indemnification will be established by the Italian judge, but it shall not exceed the value of the transported platform. The plaintiffs estimated the value of the platform in U.S.$130 million. We have not yet presented an answer and, according to our insurance policy for this platform, we believe the value of the platform does not exceed U.S.$20 million.

In 2001, we entered into joint venture agreements with certain companies (among them El Paso) in connection with Merchant Projects for the purpose of selling energy on the spot market. These agreements provided for the payment of certain contingency contributions by us in the case that the revenues from the contracts for purchase and sale of energy were not sufficient to offset certain costs. Our projections for the Brazilian energy market did not materialize and we made contingency contribution payments systematically each month.

During 2004, we tried to negotiate with El Paso without success and initiated arbitral and judicial proceedings aiming the cease the contingency contribution payments. In the arbitration proceeding in 2005, the parties settled upon certain points, in order to end the pending dispute. Hence, on March 11, 2006, we signed a Quota Purchase Agreement, or QPA, in which El Paso Energy Cayger II Company, El Paso Energy Cayger III Company and El Paso Energy Cayger IV Company sold all of the quotas of El Paso Rio Grande Ltda and El Paso Rio Claro Ltda to us.

The acquisition of the quotas of these two companies ended the existing dispute between Petrobras and the El Paso Group relating to the contingent contributions of UTE Macaé Merchant, the gas-fired power plant owned by the companies we acquired. The signing of the QPA represented an extrajudicial settlement of the dispute in accordance with Brazilian law. The settlement is reflected in a Settlement Agreement, which is an exhibit to the QPA. The Settlement Agreement terminates any arbitration or judicial proceeding relating to this matter. The value of the entire operation was U.S.$357.5 million.

Labor Claims

We are a defendant in five labor lawsuits filed by oil workers unions with labor courts in Rio de Janeiro, Sergipe and São Paulo related to our alleged failure to index salaries in accordance with the official inflation rates published by the Brazilian government in 1989. In Rio de Janeiro and Sergipe, we lost two lawsuits and the decisions are currently being enforced. We appealed one of such lawsuits and the decision is currently under examination by the court. The comdenations in Rio de Janeiro and Sergipe refer to the months of February and August of 1989. In São Paulo, we were successful in revoking one decision and are awaiting on the judgement of one appeal before the Federal Supreme Court.

Tax Claims

We received several tax assessments from the INSS alleging irregular presentation of documentation by construction companies and other service providers under contract with us with regard to their INSS contributions. The INSS seeks to hold us jointly and severally liable for contributions not made by these providers, as set forth by applicable law. We are analyzing each of the INSS assessments in order to attempt to recover payments that we made to the INSS with respect to these tax assessments. In addition, we intend to take action against service providers in order to recover any amounts paid and not recovered from the INSS, based on our right to contribution. Because it is unlikely that we will successfully obtain a reversal of the INSS decision through the agency s administrative procedures, at December 31, 2005, we had a balance of U.S.$72 million in our provision to cover future payments to the INSS.

Federal tax authorities (*Delegacia da Receita Federal*) have served us with a tax assessment of approximately R$566 million related to a withholding tax (IRRF) that they believe should have been paid in connection with remittances we made abroad between 1998 and 2002. On December 31, 2005, this amount corresponded to approximately R$634 million (approximately U.S.$271 million). The remittances were related to the purchase of imported oil by us. According to the federal tax authorities, such remittances corresponded to interest payments, which they believe would give rise to the tax levy they claim. However, the importation documents do not make reference to the alleged interest payments. In May 2006, we were notified that the

Delegacia da Receita Federal denied the tax assessment. However, this is not a final decision and is subject to appeal at the administrative level.

The Brazilian Revenue Service has filed two tax assessments against us in connection with the withholding tax, or IRRF on foreign remittances of payments related to the charter of vessels of movable platform types. On February 17, 2003, the Brazilian Revenue Service served us with a tax assessment notice for R$93 million (approximately U.S.$32 million) covering disputed taxes for 1998. On December 31, 2005, this amount corresponded to approximately R$112 million (approximately U.S.$48 million). On June 27, 2003, the Brazilian Revenue Service served us with a tax assessment notice for R$3,064 million (approximately U.S.$1,066 million) covering disputed taxes for the period from 1999 to 2002. On December 31, 2005, this amount corresponded to to R$3,826 million (approximately U.S.$1,635 million). We appealed the two unfavorable rulings from the Brazilian Revenue Service with respect to these tax assessments to a higher administrative court. The administrative denied both of our appeals, upholding the tax assessments imposed by the Federal Revenue Office in Rio de Janeiro and declaring that the so-called zero tax percentage rule is not applicable to us. We will continue to appeal the tax assessment at the federal administrative level and later at the federal judicial level, if necessary.

Certain independent distributors located throughout Brazil have brought claims against us. Collectively, these claims total approximately R$821.48 million (U.S.$394 million) and aim at the restitution of the ICMS retained from such distributors and collected by us in favor of many states, plus damages. We believe these taxes were properly collected and represent valid state value-added tax credits. However, in connection with these claims, approximately R$76 million (U.S.$32 million) in injunctive relief was declared against us in various local courts and seized from our accounts in several jurisdictions in anticipation of favorable judgments for the distributors. Upon appeal, these rulings were subsequently overruled. However, only about U.S.$2.5 million of those amounts has been returned to us so far.

Environmental Claims

In the period between 2000 to 2005, we experienced several accidents, some of them leading to significant oil spills: 71,141 gallons in 2005, 140,000 gallons in 2004, 73,000 gallons in 2003, 52,000 gallons in 2002 and 691,000 gallons in 2001. As a result of certain of these accidents, several administrative, civil and criminal investigations and proceedings have not yet been concluded, the most significant of which are specified below. We cannot predict whether additional litigation will result from those accidents or whether any such additional proceedings would have a material adverse effect on us. See Note 21(d) to our audited consolidated financial statements.

January 2000 spill Guanabara Bay

On January 18, 2000, a pipeline connecting one of our terminals to a refinery in Guanabara Bay ruptured, causing a release of approximately 341,000 gallons of crude oil into the bay. We undertook action to control the spill in an effort to prevent the oil from threatening additional areas. We have spent approximately R$104 million in connection with the clean-up efforts and fines imposed by IBAMA in connection with this spill, and are subject to several legal proceedings that remain pending as a result of this spill, including a criminal proceeding instituted on January 24, 2001 by the Public Ministry of the State of Rio de Janeiro. The initial ruling declared the proceeding invalid by virtue of the Federal Constitution of Brazil, which permits only individuals, not legal entities, to be held criminally liable. This ruling cannot be appealed. In addition, on April 30, 2002, a decision from the court determined the conclusion of the criminal proceeding. Although this decision is favorable to us and is not subject to appeal by the plaintiff, we nevertheless appealed to the Brazilian Court of Justice (*Superior Tribunal de Justiça*, or STJ) in order to seek additional rulings in our favor.

July 2000 Spill Curitiba

On July 16, 2000, an oil spill occurred at our President Getúlio Vargas refinery, located approximately 15 miles (24 kilometers) from Curitiba, capital of the State of Paraná, releasing approximately 1.06 million gallons of crude oil into the surrounding area. We spent approximately R$74 million on the clean-up effort and fines imposed by the State of Paraná authorities. In addition, in relation to this spill:

on August 1, 2000, IBAMA imposed fines in the amount of R$168 million. We contested these fines, but IBAMA subsequently upheld them. On February 3, 2003, we filed a lawsuit in order to challenge these fines and obtained an injunction that allows us to pursue a decision to this claim without posting a bond in the amount of the fines. We are currently awaiting a final disposition of this case;

several civil actions have been filed against us, the most important of which is a civil action filed on January 1, 2001 by the Federal Public Ministry and the Paraná State Public Ministry seeking damages of approximately R$2,300 million. On April 4, 2001, we filed our response and are still awaiting a decision; and

the Federal Public Ministry instituted a criminal action against us, our former president and our former superintendent of the REPAR refinery. A habeas corpus petition has currently suspended the action in favor of us, our former president and the former superintendent of the REPAR refinery. In addition, with respect to our former president and REPAR refinery s former superintendent, the STF and STJ have each concluded their criminal proceedings. We await a final decision on the merits.

February 2001 spill Rivers in the State of Paraná

On February 16, 2001, our Araucária-Paranaguá pipeline ruptured as a result of an unusual movement of the soil and spilled approximately 15,059 gallons of fuel oil into several rivers located in the State of Paraná. On February 20, 2001, we finalized the cleaning of the river surfaces, recovering approximately 13,738 gallons of fuel oil. As a result of the accident:

the *Instituto Ambiental do Paraná*, or IAP fined us approximately R$150 million. We contested this fine, and IAP reduced the fine to R$90 million. We contested the reduced fine, but the legal proceeding was suspended by decision of the court;

the Federal Public Ministry and the Paraná State Public Ministry filed a public civil action against us seeking damages of approximately R$3,700 million and to oblige us to take certain remedial steps to prevent future accidents. On July 19, 2002, we filed our response, but the legal proceeding was suspended by decision of the court; and

the Federal Police of the State of Paraná conducted a criminal investigation, which has been concluded.

March 2001 gas explosion and spill Roncador field

On March 15, 2001, a gas explosion inside one of the columns of the P-36 production platform, located in the Roncador field (75 miles off the Brazilian coast) led to the death of 11 employees and eventual sinking of the platform. The accident also caused 396,300 gallons of oil to spill into the ocean. As a result of the accident:

the Federal Public Ministry filed a lawsuit on January 23, 2002 seeking the payment of R$100 million as environmental damages, among other demands. We have presented our defense to these claims and are awaiting a decision; and

IBAMA fined us approximately R$7 million. We are contesting these fines through administrative proceedings.

October 2002 FPSO accident

On October 13, 2002, a power blackout in FPSO P-34, which is located in the Barracuda-Caratinga fields, affected the ship s water balance system and caused water to move from storage tanks located in one side of the ship to the tanks located in the opposite side, causing the FPSO to roll up to an angle of 40 degrees. Four days later, the stability of the ship had been restored, without casualties or spill of oil into the sea. As a result of the investigation of

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this accident, several measures to prevent similar accidents were incorporated into our *Programa de Excelência Operacional, or PEO* (Operational Excellence Program). In connection with the accident:

- we executed a *Termo de Ajustamento de Conduta* (Agreement for Regularization of Conduct), or TAC, with IBAMA, relating to our production activities in the Campos Basin, pursuant to a Presidential Decree enacted on December 12, 2002. Under the TAC, we agreed to conduct certain actions in the Campos Basin to reduce the risk of environmental damage;

- following the FPSO P-34 accident, the *Comissão Estadual de Controle Ambiental* (State Commission for Environment Control, or CECA) fined as in R$1 million because our exploration license in Campos Basin had allegedly expired. We are contesting this fine through administrative proceedings.

- on January 16, 2003, the Federal Public Ministry filed a motion for a protective order with a request for an injunction against us, IBAMA and *Agência Nacional do Petróleo* (National Petroleum Agency, or ANP), in order to challenge the validity of the letter of intent and of the TAC and prevent us from obtaining from IBAMA new licenses for our platforms located in the Campos Basin. The trial judge partially accepted the plaintiff s request for an injunction. The court suspended the injunction, upholding the validity of the TAC, which is not subject to appeal. The proceedings at the trial court will continue until the trial judge makes a final decision on the merits of the complaint, which decision would be subject to further appeals.

Campos Basin Perforations

On February 3, 2006 IBAMA imposed a fine on us in the amount of R$213.2 million for the performance of some perforations in the Campos basin in alleged breach of the agreement (termo de ajustamento de conduta) executed between Petrobras and IBAMA on August 11, 2004. On February 16, 2006, we contested the fine through an administrative proceeding with IBAMA, but no decision has been issued yet. We believe the perforation performed by Petrobras along the Brazilian coast, including the perforation performed on the Campos Basin, is legitimate based on IBAMA s Previous Perforation License, Federal Government Decree of December 9, 2002, and the agreement (termo de ajustamento de conduta) executed between Petrobras and IBAMA, which is valid through December 31, 2006.

Pollution

On January 15, 1986, the Public Ministry of the State of São Paulo and the *União dos Defensores da Terra* (Union for Defense of the Earth), filed a public civil action against us and 23 other companies in the State Court of São Paulo for alleged damages caused by pollution. This lawsuit is entering the discovery phase. Although the plaintiffs alleged damages of U.S.$89,500 in an initial pleading filed with the Court, the Public Ministry of the State of São Paulo has publicly stated that U.S.$800 million ultimately will be required to remedy the alleged environmental damage. The Court refused to assert joint and several liability of the defendants, and we believe that it will be difficult to determine the environmental damage attributable to each defendant.

PIFCo

There is no litigation or governmental proceeding pending or, to PIFCo s knowledge, threatened against PIFCo s or any of its subsidiaries that, if adversely determined, would have a significant effect on its financial position or profitability.

Dividend Distribution

Petrobras

The tables below describe our dividend payments for the last five fiscal years, including amounts paid in the form of interest on shareholders equity.

	For the Year Ended December 31,				
	2005	**2004**	**2003**	**2002**	**2001**
	(in millions of U.S. dollars)				
Dividends paid to shareholders	2.104	1.785	941	999	1.702
Dividends paid to minority interests	6	24	2	19	23

	2.110	1.809	943	1.018	1.725

For our policy on mandatory dividend distribution see Item 10. Additional Information Memorandum and Articles of Incorporation of Petrobras Payment of Dividends and Interest on Shareholders Equity and Item 10. Additional Information Memorandum and Articles of Incorporation of Petrobras Mandatory Distribution. We may change our dividend policy at any time within the limits set forth by Brazilian law.

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PIFCo

For a description of PIFCo s dividend distribution policy, see Items 111 through 118 Amended and Restated Memorandum and Articles of Association of PIFCo Dividends.

ITEM 9. THE OFFER AND LISTING

Petrobras

Trading Markets

Our shares and ADSs are listed or quoted on the following markets:

Common Shares	São Paulo Stock Exchange (BOVESPA)	São Paulo (ticker symbol PETR3); Mercado de Valores Latinoamericanos en Euros (LATIBEX) Madrid, Spain (ticker symbol XPBR)
Preferred Shares	São Paulo Stock Exchange (BOVESPA)	São Paulo (ticker symbol PETR4); Mercado de Valores Latinoamericanos en Euros (LATIBEX) Madrid, Spain (ticker symbol XPBRA)
Common ADSs	New York Stock Exchange (NYSE)	New York (ticker symbol PBR)
Preferred ADSs	New York Stock Exchange (NYSE)	New York (ticker symbol PBRA)
Common Shares	Bolsa de Comercio de Buenos Aires (BCBA)	Buenos Aires, Argentina (ticker symbol APBR)
Preferred Shares	Bolsa de Comercio de Buenos Aires (BCBA)	Buenos Aires, Argentina (ticker symbol APBRA)

Our common and preferred shares are traded on the São Paulo Stock Exchange since 1968. Our ADSs representing four common shares and our ADSs representing four preferred shares are traded on the New York Stock Exchange since 2000 and 2001, respectively. Citibank N.A. serves as the depositary for both the common and preferred ADSs. Our common and preferred shares are traded on the LATIBEX since 2002. The LATIBEX is an electronic market created in 1999 by the Madrid stock exchange in order to enable trading of Latin American equity securities in euro denominations.

Our common and preferred shares have been traded on the Bolsa de Comercio de Buenos Aires (Buenos Aires Stock Exchange) since April 27, 2006.

Price Information

São Paulo Stock Exchange

The tables below set forth reported high and low closing sale prices in *reais* per common and preferred share and the reported average daily trading volume in common and preferred shares on the São Paulo Stock Exchange for the periods indicated. The table also sets forth prices in U.S. dollars per common and preferred share at the commercial market rate for the purchase of U.S. dollars, as reported by the Central Bank of Brazil, for each of the dates of such quotations. See Item 3. Key Information Exchange Rates for information with respect to exchange rates applicable during the periods set forth below.

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	COMMON SHARES TRADED ON BOVESPA				
	reais per Common Share		U.S. dollars per Common Share		Average Number of Common Shares Traded per Day
	High	Low	High	Low	
2001	17.54	11.88	7.44	4.57	1,511,636
2002	15.78	9.47	6.73	2.45	1,630,564
2003	21.13	11.50	7.26	3.22	1,290,236
2004	26.93	19.14	10.09	5.99	1,330,192
2005	41.80	25.40	18.37	9.39	973,131
2004:					
First Quarter	24.30	21.25	8.50	7.24	1,205,632
Second Quarter	25.33	19.14	8.77	5.99	1,587,788
Third Quarter	26.00	20.50	9.08	6.66	1,369,444
Fourth Quarter	26.93	24.63	10.09	8.61	1,153,792
2005:					
First Quarter	33.08	25.40	12.40	9.39	1,224,093
Second Quarter	31.50	26.08	13.21	10.16	894,337
Third Quarter	41.80	29.58	18.33	12.49	996,648
Fourth Quarter	41.30	33.31	18.37	14.82	782,600
2006:					
First Quarter	51.69	42.30	23.34	18.09	1,092,195
2005:					
November	38.14	33.77	17.04	15.53	804,980
December	41.30	38.55	18.37	16.83	590,943
2006:					
January	51.69	42.30	23.34	18.09	1,078,319
February	51.30	44.77	23.14	20.80	1,213,922
March	49.39	45.00	23.34	20.68	1,009,600
April	51.78	47.22	24.48	22.07	937,050
May	55.40	48.80	26.85	20.64	1,433,145

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	PREFERRED SHARES TRADED ON BOVESPA				
	reais per Preferred Share		U.S. dollars per Preferred Share		Average Number of Preferred Shares Traded per Day
	High	Low	High	Low	
2001	15.53	11.24	7.28	4.48	4,315,400
2002	15.08	8.79	6.43	2.27	4,269,480
2003	19.37	10.40	6.67	2.90	4,584,204
2004	24.47	16.80	9.17	5.26	4,825,476
2005	37.21	22.74	16.50	8.37	4,578,877
2004:					
First Quarter	22.05	19.45	7.74	6.64	5,264,380
Second Quarter	22.13	16.80	7.66	5.26	5,293,356
Third Quarter	23.46	18.50	8.21	6.01	4,297,276
Fourth Quarter	24.47	22.40	9.17	7.93	4,458,008
2005:					
First Quarter	28.94	22.74	10.86	8.37	4,957,720
Second Quarter	27.70	22.98	11.62	8.87	3,952,243
Third Quarter	37.01	26.03	16.25	10.84	4,638,194
Fourth Quarter	37.21	29.46	16.50	13.11	4,790,216
2006:					
First Quarter	47.00	38.09	21.50	16.29	6,257,082
2005					
November	34.55	30.85	15.53	14.07	4,961,148
December	37.21	35.00	16.50	15.24	3,698,110
2006:					
January	47.00	38.09	21.22	16.29	5,375,848
February	46.75	40.80	21.11	18.94	7,258,169
March	45.50	40.90	21.50	18.75	6,278,227
April	46.69	43.29	22.13	20.26	5,604,167
May	48.15	42.50	23.33	17.96	7,473,100

New York Stock Exchange

The tables below set forth the reported high and low closing sale prices per ADSs representing four common shares and ADSs representing four preferred shares and their reported average daily trading volume on the New York Stock Exchange for the periods indicated.

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	COMMON SHARE ADS TRADED ON THE NYSE				
	reais per ADS representing One Common Share		U.S. dollars per ADS representing One Common Share		Average Number of ADS representing One Common Share Traded per Day
	High	Low	High	Low	
2001	69.46	47.58	30.06	18.14	838,939
2002	63.58	36.91	27.30	9.55	1,223,509
2003	84.77	46.21	29.27	12.94	1,044,189
2004	107.74	77.77	40.37	24.35	1,371,604
2005	167.06	101.24	73.40	37.41	1,754,301
2004:					
First Quarter	98.74	85.82	34.11	29.28	1,546,458
Second Quarter	101.45	77.77	35.14	24.35	1,641,156
Third Quarter	103.48	81.99	36.05	26.86	1,106,792
Fourth Quarter	107.74	98.05	40.37	34.43	1,205,897
2005:					
First Quarter	131.47	101.24	49.81	37.41	1,967,233
Second Quarter	126.29	104.29	52.97	41.00	1,313,044
Third Quarter	167.06	118.03	73.37	49.54	1,808,566
Fourth Quarter	166.45	132.48	73.40	58.95	1,941,263
2006:					
First Quarter	209.26	173.71	94.50	74.72	2,267,705
2005:					
November	151.94	134.74	67.79	62.06	1,896,714
December	166.45	155.80	73.40	67.16	1,426,200
2006:					
January	209.26	173.71	94.50	74.72	2,247,450
February	203.72	179.02	91.65	83.11	2,300,853
March	196.45	180.85	92.83	82.69	2,257,935
April	211.15	188.51	99.53	88.44	2,252,600
May	220.63	191.98	106.92	82.39	3,591,950

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	PREFERRED SHARE ADS TRADED ON THE NYSE				
	reais per ADS representing		U.S. dollars per ADS representing		Average Number of ADS representing One Preferred Share Traded per Day
	One Preferred Share		One Preferred Share		
	High	Low	High	Low	
2001	62.05	44.76	29.38	17.70	533,883
2002	60.81	34.40	25.95	8.90	683,403
2003	77.50	41.57	26.79	11.63	671,236
2004	97.94	66.59	36.70	20.85	818,145
2005	150.34	89.91	66.20	33.43	1,184,789
2004:					
First Quarter	88.26	78.53	30.99	26.76	797,526
Second Quarter	88.31	66.59	30.59	20.85	925,295
Third Quarter	92.92	73.43	32.37	24.11	693,322
Fourth Quarter	97.94	89.27	36.70	31.67	859,141
2005:					
First Quarter	115.73	90.84	43.62	33.43	1,567,575
Second Quarter	110.87	89.91	46.50	35.60	904,878
Third Quarter	147.74	103.74	64.93	42.78	1,161,931
Fourth Quarter	150.34	118.14	66.20	52.57	1,121,729
2006:					
First Quarter	190.88	157.93	86.20	67.75	1,317,177
2005:					
November	138.69	122.74	61.88	56.09	1,149,305
December	150.34	141.65	66.20	60.61	796,524
2006:					
January	190.88	157.93	86.20	67.75	1,305,980
February	184.82	162.61	83.85	75.49	1,267,253
March	181.93	164.50	85.97	74.98	1,368,157
April	190.55	172.89	89.82	81.02	1,267,942
May	193.04	167.47	93.55	71.67	1,842,509

Markets

The São Paulo Stock Exchange

In Brazil, securities are traded only on the São Paulo Stock Exchange, with the exception of electronically traded public debt securities.

If you were to trade in our common or preferred shares on the São Paulo Stock Exchange, your trade would settle in three business days after the trade without adjustment of the purchase price for inflation. The seller is ordinarily required to deliver the shares to the exchange on the third business day following the trade date. Delivery of and payment for shares are made through the facilities of the clearinghouse, or *Companhia Brasileira de Liquidação e Custódia*, known as CBLC.

The São Paulo Stock Exchange is a nonprofit entity owned by its member brokerage firms. Trading on each exchange is limited to member brokerage firms and a number of authorized nonmembers. The São Paulo Stock Exchange opens electronic trading sessions each day from 11:00 a.m. to 6:00 p.m. Brazil local time, except during daylight savings time in the United States. During daylight savings time in the United States, the sessions are from 10:00 a.m. to 5:00 p.m. Brazil local time, to closely mirror New York Stock Exchange trading hours. Trading is also

conducted between 11:00 a.m. and 6:00 p.m., or between 10:00 a.m. and 5:00 p.m. during daylight savings time in the United States, on an automated system known as the *Sistema de Negociação Assistida por Computador* (Computer Assisted Trading System) on the São Paulo Stock Exchange. The São Paulo Stock Exchange also permits trading from 6:45 p.m. to 7:30 p.m. (or from 5:45 p.m. to 7:00 p.m. during daylight savings time in the United States) on an online system connected to traditional and internet brokers called the After Market. Trading on the

After Market is subject to regulatory limits on price volatility and on the volume of shares transacted through internet brokers. There are no specialists or officially recognized market makers for our shares.

In order to better control volatility, the São Paulo Stock Exchange adopted a circuit breaker system pursuant to which trading sessions may be suspended for a period of thirty minutes or one hour whenever the indices of these stock exchanges fall below the limits of 10% or 15%, respectively, in relation to the index registered in the previous trading session.

The São Paulo Stock Exchange is less liquid than the New York Stock Exchange or other major exchanges in the world. At December 31, 2005, the aggregate market capitalization of the 339 companies listed on the São Paulo Stock Exchange was approximately U.S$482 billion and the ten largest companies represented approximately 52% of the total market capitalization of all listed companies. All the outstanding shares of an exchange-listed company may trade on the São Paulo Stock Exchange, but in most cases, less than half of the listed shares are actually available for trading by the public. The remainder is held by small groups of controlling persons, by governmental entities or by one principal shareholder.

Trading on the São Paulo Stock Exchange by a holder not deemed to be domiciled in Brazil for Brazilian tax and regulatory purposes (a non-Brazilian holder) is subject to certain limitations under Brazilian foreign investment legislation. With limited exceptions, non-Brazilian holders may only trade on the São Paulo Stock Exchange in accordance with the requirements of Resolution No. 2,689 of January 26, 2000 of the National Monetary Council. Resolution No. 2,689 requires that securities held by non-Brazilian holders be maintained in the custody of, or in deposit accounts with, financial institutions duly authorized by the Central Bank of Brazil and the CVM. In addition, Resolution No. 2,689 requires non-Brazilian holders to restrict their securities trading to transactions on Brazilian stock exchanges or qualified over-the-counter markets. With limited exceptions, non-Brazilian holders may not transfer the ownership of investments made under Resolution No. 2,689 to other non-Brazilian holders through a private transaction.

The Brazilian custodian for the common and preferred shares underlying the ADSs must, on behalf of the depositary for the ADSs, register with the Central Bank of Brazil to remit U.S. dollars abroad for payments of dividends, any other cash distributions or sales proceeds upon the disposition in Brazil of the shares. In the event that a holder of ADSs exchanges ADSs for common or preferred shares, the holder will be entitled to continue to rely on the custodian s registration for five business days after the exchange. Thereafter, the holder may not be able to obtain and remit U.S. dollars abroad upon the disposition of the common or preferred shares or distributions relating to the common shares, unless the holder obtains a new registration. See Item 10. Additional Information Exchange Controls and Additional Information Brazilian Tax Considerations Taxation of Gains for a description of exchange controls and certain tax benefits extended to non-Brazilian holders who qualify under Resolution No. 2,689.

Regulation of the Brazilian Securities Markets

The Brazilian securities markets are principally governed by Law No. 6,385 of December 7, 1976, and the Brazilian Corporation Law, each as amended and supplemented, and by regulations issued by the CVM, which has regulatory authority over the stock exchanges and securities markets generally, the National Monetary Council, and the Central Bank of Brazil, which has licensing authority over brokerage firms and regulates foreign investment and foreign exchange transactions. These laws and regulations, among others, provide for disclosure requirements applicable to issuers of traded securities, restrictions on insider trading and price manipulation and protection of minority shareholders. They also provide for licensing and oversight of brokerage firms and governance of the Brazilian stock exchanges. However, the Brazilian securities markets are not as highly regulated and supervised as the U.S. securities markets.

Under the Brazilian Corporation Law, a company is either public (*companhia aberta*), such as we are, or privately held (*companhia fechada*). All public companies, including us, are registered with the CVM and are subject to reporting requirements. A company registered with the CVM may have its securities traded on the Brazilian stock exchanges or in the Brazilian over-the-counter market. Our common and preferred shares are listed and traded on the São Paulo Stock Exchange and may also be traded privately, subject to some limitations.

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To be listed on the São Paulo Stock Exchange, a company must apply for registration with the CVM and the São Paulo Stock Exchange.

We have the option to ask that trading in our securities on the São Paulo Stock Exchange be suspended in anticipation of a material announcement. Trading may also be suspended on the initiative of the São Paulo Stock Exchange or the CVM, among other reasons, based on or due to a belief that a company has provided inadequate information regarding a material event or has provided inadequate responses to the inquiries by the CVM or the São Paulo Stock Exchange.

The Brazilian over-the-counter market consists of direct trades between individuals in which a financial institution registered with the CVM serves as intermediary. No special application, other than registration with the CVM, is necessary for securities of a public company to be traded in this market. The CVM requires that it be given notice of all trades carried out in the Brazilian over-the-counter market by the intermediaries.

PIFCo

PIFCo s common stock is not registered and there is no trading market for it. PIFCo s Senior Notes are listed in the Luxembourg Stock Exchange. PIFCo s other debt securities have not been listed on any securities exchange.

ITEM 10. ADDITIONAL INFORMATION

Memorandum and Articles of Incorporation of Petrobras

General

We are a publicly traded company duly registered with the CVM under No. 951-2. Article 3 of our bylaws establishes our corporate purposes as research, prospecting, extraction, processing, trade and transportation of crude oil from wells, shale and other rocks, of its derivatives, natural gas and other fluid hydrocarbons, as well as other related or similar activities, such as activities connected with energy, including research, development, production, transportation, distribution, sale and trade of all forms of energy, as well as other related or similar activities. We may conduct outside Brazil, directly or through our subsidiaries, any of the activities within our corporate purpose.

Qualification of Directors

Brazilian law provides that only shareholders of a company may be appointed to its board of directors, but there is no minimum share ownership or residency requirement for qualification as a director. Members of our board of executive officers must be Brazilian nationals and reside in Brazil. Our directors and executive officers are prevented from voting on any transaction involving companies in which they hold more than 10% of the total capital stock or of which they have held a management position in the period immediately prior to their taking office. Under our bylaws, shareholders set the aggregate compensation payable to directors and executive officers. The Board of Directors allocates the compensation among its members and the executive officers.

Allocation of Net Income

At each annual general shareholders meeting, our board of directors is required to recommend how net profits for the preceding fiscal year are to be allocated. The Brazilian Corporation Law defines net profits as net income after income taxes and social contribution taxes for such fiscal year, net of any accumulated losses from prior fiscal years and any amounts allocated to employees and management s participation in our profits. In accordance with the Brazilian Corporation Law, the amounts available for dividend distribution or payment of interest on shareholders equity equals net profits less any amounts allocated from such net profits to the legal reserve.

We are required to maintain a legal reserve, to which we must allocate 5% of net profits for each fiscal year until the amount for such reserve equals 20% of our paid-in capital. However, we are not required to make any

allocations to our legal reserve in a fiscal year in which the legal reserve, when added to our other established capital reserves, exceeds 30% of our capital. The legal reserve can only be used to offset losses or to increase our capital.

As long as we are able to make the minimum mandatory distribution described below, we must allocate an amount equivalent to 0.5% of subscribed and fully paid-in capital at year-end to a statutory reserve. The reserve is used to fund the costs of research and technological development programs. The accumulated balance of this reserve cannot exceed 5% of the subscribed and fully paid-in capital stock.

Brazilian law also provides for three discretionary allocations of net profits that are subject to approval by the shareholders at the annual general shareholders meeting, as follows:

- first, a percentage of net profits may be allocated to a contingency reserve for anticipated losses that are deemed probable in future years. Any amount so allocated in a prior year must be either reversed in the fiscal year in which the reasons justifying the reserve cease to exist, or written off in the event that the anticipated loss occurs;

- second, if the mandatory distributable amount exceeds the sum of realized net profits in a given year, this excess may be allocated to an unrealized revenue reserve. The Brazilian Corporation Law defines realized net profits as the amount of net profits that exceeds the net positive result of equity adjustments and profits or revenues from operations whose financial results take place after the end of the next succeeding fiscal year; and

- third, a portion of our net profits that exceeds the minimum mandatory distribution may be allocated to fund working capital needs and investment projects, as long as such allocation is based on a capital budget previously approved by our shareholders. Capital budgets for more than one year must be reviewed at each annual shareholders meeting.

Mandatory Distribution

Under Brazilian Corporation Law, the bylaws of a Brazilian corporation may specify a minimum percentage of the amounts available for distribution by such corporation for each fiscal year that must be distributed to shareholders as dividends or interest on shareholders equity, also known as the mandatory distributable amount, which cannot be lower than 25% of the adjusted net profit for the fiscal year. Under our bylaws, the mandatory distributable amount has been fixed at an amount equal to not less than 25% of our net profits, after the allocations to the legal reserve, contingency reserve and unrealized revenue reserve. Furthermore, the net profits that are not allocated to the reserves above to fund working capital needs and investment projects as described above or to the statutory reserve must be distributed to our shareholders as dividends or interest on shareholders equity.

The Brazilian Corporation Law, however, permits a publicly held company, such as ours, to suspend the mandatory distribution if the board of directors and the fiscal council report to the annual general shareholders meeting that the distribution would be inadvisable in view of the company s financial condition. The suspension is subject to approval of holders of common shares. In this case, the board of directors must file a justification for such suspension with the CVM. Profits not distributed by virtue of the suspension mentioned above shall be allocated to a special reserve and, if not absorbed by subsequent losses, shall be distributed as soon as the financial condition of the company permits such payments.

Payment of Dividends and Interest on Shareholders Equity

We are required by the Brazilian Corporation Law and by our bylaws to hold an annual general shareholders meeting by the fourth month after the end of each fiscal year at which, among other things, the shareholders have to decide on the payment of an annual dividend. The payment of annual dividends is based on the financial statements prepared for the relevant fiscal year.

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Law No. 9,249 of December 26, 1995, as amended, provides for distribution of interest attributed to shareholders equity to shareholders as an alternative form of distribution. Such interest is limited to the daily *pro rata* variation of the TJLP interest rate, the Brazilian government s long-term interest rate.

We may treat these payments as a deductible expense for corporate income tax and social contribution purposes, but the deduction cannot exceed the greater of:

- 50% of net income (before taking into account such distribution and any deductions for income taxes and after taking into account any deductions for social contributions on net profits) for the period in respect of which the payment is made; or

- 50% of retained earnings.

Any payment of interest on shareholders equity to holders of ADSs or common shares, whether or not they are Brazilian residents, is subject to Brazilian withholding tax at the rate of 15% or 25%. The 25% rate applies if the beneficiary is resident in a tax haven. See Brazilian Tax Considerations. The amount paid to shareholders as interest attributed to shareholders equity, net of any withholding tax, may be included as part of any mandatory distribution of dividends. Under the Brazilian Corporation Law, we are required to distribute to shareholders an amount sufficient to ensure that the net amount received, after payment by us of applicable Brazilian withholding taxes in respect of the distribution of interest on shareholders equity, is at least equal to the mandatory dividend.

Under the Brazilian Corporation Law and our bylaws, dividends generally are required to be paid within 60 days following the date the dividend was declared, unless a shareholders resolution sets forth another date of payment, which, in either case, must occur prior to the end of the fiscal year in which the dividend was declared. The amounts of dividends due to our shareholders are subject to financial charges at the SELIC rate (an interest rate applicable to certain Brazilian government securities) from the end of each fiscal year through the date we actually pay such dividends. Shareholders have a three-year period from the dividend payment date to claim dividends or interest payments with respect to their shares, after which the amount of the unclaimed dividends reverts to us.

Holders of preferred shares are entitled to priority in the distribution equal to the greater of a 5% of their pro rata share of our paid-in capital, or 3% of their shares book value with a participation equal to the common shares in corporate capital increases obtained from the incorporation of reserves and profits.

Our board of directors may distribute dividends or pay interest based on the profits reported in interim financial statements. The amount of interim dividends distributed cannot exceed the amount of our capital reserves.

Shareholders Meetings

Our shareholders have the power to decide on any matters related to our corporate purposes and to pass any resolutions they deem necessary for our protection and development, through voting at a general shareholders meeting.

We convene our shareholders meetings by publishing a notice in the *Diário Oficial da União* (Official Gazette), *Jornal do Commercio*, *Gazeta Mercantil* and *Valor Econômico*. The notice must be published no fewer than three times, beginning at least 15 calendar days prior to the scheduled meeting date. The notice must contain the meeting s agenda and, in the case of a proposed amendment to the bylaws, an indication of the subject matter. For ADS holders, we are required to provide notice to the ADS depositary at least 30 calendar days prior to a shareholders meeting.

The board of directors or, in some specific situations set forth in the Brazilian Corporation Law, the shareholders, call our general shareholders meetings. A shareholder may be represented at a general shareholders meeting by an attorney-in-fact, so long as the attorney-in-fact was appointed within a year of the meeting. The attorney-in-fact must be a shareholder, a member of our management, a lawyer or a financial institution. The attorney-in-fact s power of attorney must comply with certain formalities set forth by Brazilian law.

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In order for a valid action to be taken at a shareholders meeting, shareholders representing at least one quarter of our issued and outstanding common shares must be present at the meeting. However, in the case of a general meeting to amend our bylaws, shareholders representing at least two-thirds of our issued and outstanding common shares must be present. If no such quorum is present, the board may call a second meeting giving at least eight calendar days notice prior to the scheduled meeting in accordance with the rules of publication described above. The quorum requirements will not apply to the second meeting, subject to the voting requirements for certain matters described below.

Voting Rights

Pursuant to the Brazilian Corporation Law and our bylaws, each of our common shares carries the right to vote at a general meeting of shareholders. The Brazilian government is required by law to own at least a majority of our voting stock. Pursuant to our bylaws, our preferred shares generally do not confer voting rights.

Holders of common shares, voting at a general shareholders meeting, have the exclusive power to:

- amend our bylaws;
- approve any capital increase beyond the amount of the authorized capital;
- approve any capital reduction;
- approve the appraisal of any assets used by a shareholder to subscribe for our shares;
- elect or dismiss members of our board of directors and fiscal council, subject to the right of our preferred shareholders to elect or dismiss one member of our board of directors and to elect one member of our fiscal council;
- receive the yearly financial statements prepared by our management and accept or reject management s financial statements, including the allocation of net profits for payment of the mandatory dividend and allocation to the various reserve accounts;
- authorize the issuance of debentures, except for the issuance of non-convertible unsecured debentures, which may be approved by our board of directors;
- suspend the rights of a shareholder who has not fulfilled the obligations imposed by law or by our bylaws;
- accept or reject the valuation of assets contributed by a shareholder in consideration for issuance of capital stock;
- pass resolutions to approve corporate restructurings, such as mergers, spin-offs and transformation into another type of company;
- participate in a centralized group of companies;
- approve the disposal of the control of our subsidiaries;
- approve the disposal of convertible debentures issued by our subsidiaries and held by us;
- establish the compensation of our senior management;
- approve the cancellation of our registration as a publicly-traded company;

- decide on our dissolution or liquidation;
- waive the right to subscribe to shares or convertible debentures issued by our subsidiaries or affiliates; and
- choose a specialized company to work out the appraisal of our shares by economic value, in cases of the canceling of our registry as a publicly-traded company or deviation from the standard rules of corporate governance defined by a stock exchange or an entity in charge of maintaining an organized over-the-counter market registered with the CVM, in order to comply with such corporate governance rules and with contracts that may be executed by us and such entities.

Except as otherwise provided by law, resolutions of a general shareholders meeting are passed by the majority of the outstanding common shares. Abstentions are not taken into account.

The approval of holders of at least one-half of the issued and outstanding common shares is required for the following actions involving our company:

- reduction of the mandatory dividend distribution;
- merger into another company or consolidation with another company, subject to the conditions set forth in the Brazilian Corporation Law;
- participation in a group of companies subject to the conditions set forth in the Brazilian Corporation Law;
- change of our corporate purpose, which must be preceded by an amendment in our bylaws by federal law as we are controlled by the government and our corporate purpose is established by law;
- cessation of the state of liquidation;
- spin-off of a portion of our company, subject to the conditions set forth in the Brazilian Corporation Law;
- transfer of all our shares to another company or receipt of shares of another company in order to make the company whose shares are transferred a wholly-owned subsidiary of such company, known as *incorporação de ações*; and
- approval of our liquidation.

According to the Brazilian Corporation Law, the following actions shall be submitted for approval by the outstanding adversely affected preferred shares before they are submitted for approval of al least half of the issued and outstanding common shares:

- creation of preferred shares or increase in the existing classes of preferred shares, without preserving the proportions to any other class of preferred shares, except as set forth in or authorized by the company s bylaws;
- change in the preferences, privileges or redemption or amortization conditions of any class of preferred shares; and
- creation of a new class of preferred shares entitled to more favorable conditions than the existing classes.

Decisions on our transformation into another type of company require the unanimous approval of our shareholders, including the preferred shareholders, and an amendment of our bylaws by the federal law.

Our preferred shares will acquire voting rights if we fail to pay the minimum dividend to which such shares are entitled for three consecutive fiscal years. The voting right shall continue until payment has been made. Preferred shareholders also obtain the right to vote if we enter into a liquidation process.

Under Brazilian Corporation Law, shareholders representing at least 10% of the company s voting capital have the right to demand that a cumulative voting procedure be adopted to entitle each common share to as many votes as there are board members and to give each common share the right to vote cumulatively for only one candidate or to distribute its votes among several candidates. Furthermore, minority common shareholders holding at least 10% of our voting capital also have the right to appoint or dismiss one member to or from our fiscal council.

Preferred shareholders holding, individually or as a group, 10% of our total capital have the right to appoint and/or dismiss one member to or from our board of directors. Preferred shareholders have the right to separately appoint one member to or from our fiscal council.

Our bylaws provide that, independently from the exercise of the rights above granted to minority shareholders, through cumulative voting process, the Brazilian government always has the right to appoint the majority of our directors.

Preemptive Rights

Pursuant to the Brazilian Corporation Law, each of our shareholders has a general preemptive right to subscribe for shares or securities convertible into shares in any capital increase, in proportion to the number of shares held by them. In the event of a capital increase that would maintain or increase the proportion of capital represented by the preferred shares, holders of preferred shares would have preemptive rights to subscribe to newly issued preferred shares only. In the event of a capital increase that would reduce the proportion of capital represented by the preferred shares, holders of preferred shares would have preemptive rights to subscribe to any new preferred shares in proportion to the number of shares held by them, and to common shares only to the extent necessary to prevent dilution of their interests in our total capital.

A period of at least 30 days following the publication of notice of the issuance of new shares or securities convertible into shares is allowed for exercise of the right, and the right is negotiable. According to our bylaws, our board of directors may eliminate preemptive rights or reduce the exercise period in connection with a public exchange made to acquire control of another company or in connection with a public offering of shares or securities convertible into shares.

In the event of a capital increase by means of the issuance of new shares, holders of ADSs, of common or preferred shares, would have, except under circumstances described above, preemptive rights to subscribe for any class of our newly issued shares. However, you may not be able to exercise the preemptive rights relating to the preferred shares underlying your ADSs unless a registration statement under the Securities Act is effective with respect to those rights or an exemption from the registration requirements of the Securities Act is available. See Item 3. Key Information Risk Factors Risks Relating to our Equity and Debt Securities.

Redemption and Rights of Withdrawal

Brazilian law provides that, under limited circumstances, a shareholder has the right to withdraw his or her equity interest from the company and to receive payment for the portion of shareholder s equity attributable to his or her equity interest.

This right of withdrawal may be exercised by the holders of the adversely affected common or preferred shares in the event that we decide:

- to create preferred shares or to increase the existing classes of preferred shares, without preserving the proportions to any other class of preferred shares, except as set forth in or authorized by our bylaws; or
- to change the preferences, privileges or redemption or amortization conditions of any class of preferred shares or to create a new class of preferred shares entitled to more favorable conditions than the existing classes.

Holders of our common shares may exercise their right of withdrawal in the event we decide:

- to merge into another company or to consolidate with another company, subject to the conditions set forth in the Brazilian Corporation Law; or
- to participate in a centralized group of companies as defined under the Brazilian Corporation Law and subject to the conditions set forth therein.

The right of withdrawal may also be exercised by our dissenting shareholders in the event we decide:

- to reduce the mandatory distribution of dividends;
- to change our corporate purposes;
- to spin-off a portion of our company, subject to the conditions set forth in the Brazilian Corporation Law;
- to transfer all of our shares to another company or to receive shares of another company in order to make the company whose shares are transferred a wholly-owned subsidiary of our company, known as *incorporação de ações*; or
- to acquire control of another company at a price, which exceeds the limits set forth in the Brazilian Corporation Law, subject to, the conditions set forth in the Brazilian Corporation Law.

This right of withdrawal may also be exercised in the event that the entity resulting from a merger, *incorporação de ações*, as described above, or consolidation or spin-off of a listed company fails to become a listed company within 120 days of the shareholders meeting at which such decision was taken.

Any redemption of shares arising out of the exercise of such withdrawal rights would be made based on the book value per share, determined on the basis of the last balance sheet approved by our shareholders. However, if a shareholders meeting giving rise to redemption rights occurred more than 60 days after the date of the last approved balance sheet, a shareholder would be entitled to demand that his or her shares be valued on the basis of a new balance sheet dated within 60 days of such shareholders meeting. The right of withdrawal lapses 30 days after publication of the minutes of the shareholders meeting that approved the corporate actions described above. We would be entitled to reconsider any action giving rise to withdrawal rights within 10 days following the expiration of such rights if the withdrawal of shares of dissenting shareholders would jeopardize our financial stability.

Other Shareholders Rights

According to the Brazilian Corporation Law, neither a company s bylaws nor actions taken at a general meeting of shareholders may deprive a shareholder of some specific rights, such as:

- the right to participate in the distribution of profits;

the right to participate equally and ratably in any remaining residual assets in the event of liquidation of the company;

the right to supervise the management of the corporate business as specified in the Brazilian Corporation Law;

the right to preemptive rights in the event of a subscription of shares, debentures convertible into shares or subscription bonuses (other than with respect to a public offering of such securities, as may be set out in the bylaws); and

the right to withdraw from the company in the cases specified in the Brazilian Corporation Law.

Liquidation

In the event of a liquidation, holders of preferred shares are entitled to receive, prior to any distribution to holders of common shares, an amount equal to the paid-in capital with respect to the preferred shares.

Conversion Rights

According to our bylaws, our common shares are not convertible into preferred shares, nor are preferred shares convertible into common shares.

Liability of Our Shareholders for Further Capital Calls

Neither Brazilian law nor our bylaws provide for capital calls. Our shareholders liability for capital calls is limited to the payment of the issue price of the shares subscribed or acquired.

Form and Transfer

Our shares are registered in book-entry form and we have hired Banco do Brasil to perform all the services of safe-keeping and transfer of shares. To make the transfer, Banco do Brasil makes an entry in the register, debits the share account of the transferor and credits the share account of the transferee.

Our shareholders may choose, at their individual discretion, to hold their shares through CBLC. Shares are added to the CBLC system through Brazilian institutions, which have clearing accounts with the CBLC. Our shareholder registry indicates which shares are listed on the CBLC system. Each participating shareholder is in turn registered in a registry of beneficial shareholders maintained by the CBLC and is treated in the same manner as our registered shareholders.

Dispute Resolution

Our bylaws provide for mandatory dispute resolution through arbitration, in accordance with the rules of the *Câmara de Arbitragem do Mercado* (Market Arbitration Chamber), with respect to any dispute regarding us, our shareholders, the officers, directors and fiscal council members and involving the provisions of the Brazilian Corporation Law, our bylaws, the rules of the National Monetary Council, the Central Bank of Brazil and the CVM or any other capital markets legislation, including the provisions of any agreement entered into by us with any stock exchange or over-the-counter entity registered with the CVM, relating to adoption of differentiated corporate governance practices.

However, decisions of the Brazilian government, as exercised through voting in any general shareholders meeting, are not subject to this arbitration proceeding, in accordance with Article 238 of the Brazilian Corporation Law.

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Self-dealing Restrictions

Our controlling shareholder, the Brazilian government, and the members of our board of directors, board of executive officers and fiscal council are required, in accordance with our bylaws, to:

- refrain from dealing with our securities either in the one-month period prior to any fiscal year-end, up to the date when our financials are published, or in the period between any corporate decision to raise or reduce our stock capital, to distribute dividends or stock, and to issue any security, up to the date when the respective public releases are published; and

- communicate to us and to the stock exchange their periodical dealing plans with respect to our securities, if any, including any change or default in these plans. If the communication is an investment or divestment plan, the frequency and planned quantities must be included.

Restrictions on Non-Brazilian Holders

Non-Brazilian holders face no legal restrictions on the ownership of our common or preferred shares or of ADSs based on our common or preferred shares, and are entitled to all the rights and preferences of such common or preferred shares, as the case may be.

However, the ability to convert dividend payments and proceeds from the sale of common or preferred shares or preemptive rights into foreign currency and to remit such amounts outside Brazil is subject to restrictions under foreign investment legislation which generally requires, among other things, the registration of the relevant investment with the Central Bank of Brazil. Nonetheless, any non-Brazilian holder who registers with the CVM in accordance with Resolution No. 2,689 may buy and sell securities on the São Paulo Stock Exchange without obtaining a separate certificate of registration for each transaction.

In addition, Annex III to Resolution No. 1,289 of the National Monetary Council, as amended, known as Annex III Regulations, allows Brazilian companies to issue depositary receipts in foreign exchange markets. We currently have an ADR program for our common and preferred shares duly registered with the CVM and the Central Bank of Brazil. The proceeds from the sale of ADSs by holders outside Brazil are free of Brazilian foreign investment controls.

Transfer of Control

According to Brazilian law and our bylaws, the Brazilian government is required to own at least the majority of our voting shares. Therefore, any change in our control would require a change in the applicable legislation.

Disclosure of Shareholder Ownership

Brazilian regulations require that any person or group of persons representing the same interest that has directly or indirectly acquired or sold an interest corresponding to 5% of the total number of shares of any type or class must disclose its share ownership or divestment to the CVM and the São Paulo Stock Exchange. In addition, a statement containing the required information must be published in the newspapers. Any subsequent increase or decrease by 5% or more in ownership of shares of any type or class must be similarly disclosed.

Memorandum and Articles of Association of PIFCo

Register

PIFCo is an exempted company incorporated with limited liability in the Cayman Islands under the Companies Law, as amended, with company registration number 76600. PIFCo registered and filed its Memorandum and Articles of Association with the Registrar of Companies on September 24, 1997. The company adopted a revised amended and restated memorandum and articles of association by sole shareholder special

resolution on October 21, 2005. PIFCo was initially incorporated with the name Brasoil Finance Company, which name was changed by special resolution of PIFCo s shareholders to Petrobras International Finance Company on September 25, 1997. Since October 21, 2005, there have been no subsequent amendments to PIFCo s Memorandum and Articles of Association.

Objects and Purposes

PIFCo s Memorandum and Articles of Association grants PIFCo full power and authority to conduct marketing, sales, financing, purchase, storage and transportation of petroleum, natural gas and all other hydrocarbons and by-products thereof and any business incidental thereto.

As a matter of Cayman Islands law, PIFCo cannot trade in the Cayman Islands except in furtherance of the business carried on outside the Cayman Islands.

Directors

Directors may vote on a proposal, arrangement or contract in which they are interested. However, interested directors must declare the nature of their interest at a directors meeting. If the interested directors declare their interest, their votes are counted and they are counted in the quorum of such meeting.

The directors may, in PIFCo s name, exercise their powers to borrow money, issue debt securities and to mortgage or charge any of the undertaking or property of PIFCo and are generally responsible for its day-to-day management and administration.

Directors are not required to own shares.

Rights and Obligations of Shareholders

Dividends

Shareholders may declare dividends in a general meeting but the dividends cannot exceed the amount recommended by the directors. The directors may pay the shareholders interim dividends and may, before recommending any dividend, set aside reserves out of profits. The directors can invest these reserves in their discretion or employ them in PIFCo s business.

Dividends may be paid in cash or in kind but may only be paid out of profits or, subject to certain restrictions of Cayman Islands law, a share premium account.

Voting Rights

Votes may be cast at a general meeting by a show of hands or by a poll. On a vote by a show of hands, each shareholder or shareholder represented by proxy has one vote. On a vote by a poll, each shareholder or shareholder represented by proxy has one vote for each share owned.

Directors are elected by ordinary resolution by the shareholders at general meetings or by a board resolution of the directors. Shareholders are not entitled to vote at a general meeting unless calls or other amounts payable on their shares have been paid. In lieu of voting on a matter at a general meeting, the shareholders entitled to vote on that matter may adopt the matter by signing a written resolution.

Redemption

PIFCo may issue shares, which are redeemable by PIFCo or by its shareholders, on such terms and in such manner as the Directors may determine before the issuance of such shares. PIFCo may repurchase its own shares on such terms and in such manner as the Directors may determine and agree with the relevant shareholder.

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Shareholder Rights Upon Liquidation

If PIFCo is liquidated, the liquidator may (in accordance with an ordinary shareholder resolution):

- set a fair value on PIFCo s assets, divide all or part of PIFCo s assets among the shareholders and determine how the assets will be divided among shareholders or classes of shareholders; and
- vest all or part of PIFCo s assets in trustees.

Shareholders will not be compelled to accept any securities on which there is a liability.

Calls on Shares

Directors may make calls on the shareholders to the extent any amounts remain unpaid on their shares. Each shareholder shall pay to the company the amounts called on such shares.

Change to Rights of Shareholders

Shareholders may change the rights of their class of shares by:

- getting the written consent of two-thirds of the shareholders of that class; or
- passing a special resolution at a meeting of the shareholders of that class.

There are no general limitations on the rights to own shares specified by the articles.

General Meetings

A general meeting may be convened:

- by the directors at any time; or
- by any two shareholders holding not less than 10% of the paid-up voting share capital of PIFCo, by written request.

Notice of a general meeting is given to all shareholders.

All business carried out at a general meeting is considered special business except:

- sanctioning a dividend;
- consideration of the accounts, balance sheets, and ordinary report of the directors and auditors;
- appointment and removal of directors; and
- fixing of remuneration of the auditors.

Unanimous shareholder consent is required to carry out special business at a meeting unless notice of the special business is given in the notice of the meeting. A quorum of shareholders is required to be present at any meeting in order to carry out business. One or more shareholders holding at least a majority of the shares of PIFCo that are present in person or represented by proxy is a quorum.

There is no requirement under Cayman Islands law to convene an annual meeting or to convene any general meeting of the shareholders. The directors are permitted to designate any general meeting of shareholders as an annual general meeting.

Liability of Shareholders

In normal circumstances, the liability of any shareholder to PIFCo is limited to the amount, which such shareholder has agreed to pay in respect of the subscription of his shares.

Changes in Capital

PIFCo may increase its authorized share capital by ordinary resolution. The new shares will be subject to all of the provisions to which the original shares are subject.

PIFCo may also by ordinary resolution:

- consolidate and divide all or any of its share capital into shares of a larger amount than its existing shares;
- convert all or any part of its paid-up shares into stock and reconvert that stock into paid-up shares of any denomination;
- sub-divide existing shares into shares of a smaller amount, subject to the provisions of Section 13 of the Companies Law; and
- cancel any shares, which, at the date of the resolution, are not held or agreed to be held by any person and diminish the amount of its share capital by the amount of the shares so cancelled.

PIFCo may reduce its share capital and any capital redemption reserve by special resolution in accordance with relevant provision of Cayman Islands law.

Indemnity

PIFCo s directors and officers are indemnified out of its assets and funds against all actions, proceedings, costs, charges, expenses, losses, damages or liabilities which they incur or sustain in or regarding the conduct of PIFCo s business or affairs in the execution or discharge of their respective duties, powers, authorities or discretions. Under PIFCo s Memorandum of Association, directors and officers are excused from all liability to PIFCo, except for any losses, which arise as a result of such party s own dishonesty.

Accounts

Accounts relating to PIFCo s affairs are kept in such manner as may be determined from time to time by the directors and may be audited in such manner as may be determined from time to time by the directors. There is, however, no requirement as a matter of Cayman Islands law to have PIFCo s accounts audited.

Amendment of the Articles

PIFCo may, by special resolution of the shareholders, amend its memorandum and articles of association.

Transfer out of Jurisdiction

PIFCo may, by special resolution of the shareholders, transfer out of the Cayman Islands into any jurisdiction permitting such transfer.

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Material Contracts

Petrobras

Concession Agreements with the ANP

As provided in the Oil Law, we were granted the exclusive right, for a period of 27 years from the declaration of commercial feasibility, to exploit the crude oil reserves in all fields where we had previously commenced production. Additionally, the Oil Law established a procedural framework for us to claim exclusive exploratory rights for a period of up to three years, which was later extended to five years, with respect to areas where we could demonstrate that we had established prospects. In case of drilling success in this exploration period we could claim development rights. To perfect our claim to explore and develop these areas, we had to demonstrate that we had the requisite financial capacity to carry out these activities, either alone or through cooperative arrangements.

On August 6, 1998, we signed concession contracts with the ANP relating to 397 areas, consisting of 231 production areas, 115 exploration areas and 51 development areas. In May 1999, we relinquished 26 exploratory areas out of the 115 initially granted to us by the ANP, and obtained an extension of our exclusive exploration period from three to five years with respect to 34 exploration areas aggregating 44.0 million acres (178,033 square kilometers) and from three to six years with respect to two exploration areas aggregating 7.3 million acres (29,415 square kilometers).

The areas of the concessions not awarded to us by the ANP have been, and will continue to be, awarded through public auctions conducted by the ANP. In the seven auctions conducted thus far, we acquired concession rights that were formalized by 128 concession contracts. See Item 4. Information on the Company Exploration, Development and Production Exploration Activities Exploration Bidding Rounds.

According to the Oil Law and under our concession agreements with the ANP we are required to pay the following:

- signature bonuses;
- royalties;
- special participation charge; and
- rentals for the occupation or retention of areas.

The minimum signature bonuses are published in the bidding rules for the concessions being auctioned, but the actual amount is based on the amount of the winning bid and has to be paid upon the execution of the concession agreement. The rentals for the occupation and retention of the concession areas are also provided for in the related bidding rules and are payable annually. For a discussion of royalties, special participation tax and rentals, see Item 5. Operating and Financial Review and Prospects Effect of Taxes on Our Income.

With respect to onshore fields, the Oil Law also requires us to pay the owner of the land a special participation fee that varies between 0.5% and 1.0% of the net operating revenues derived from the production of the field.

For information concerning our other material contracts, see Item 4. Information on the Company and Item 5. Operating and Financial Review and Prospects.

PIFCo

For a description of PIFCo s material agreements, see PIFCo Senior Notes, PIFCo Global Notes and Sale of Fu Receivables.

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Statements contained in this annual report regarding the contents of any contract or other document are not necessarily complete, and, where the contract or other document is an exhibit to the annual report, each of these statements is qualified in all aspects by the provisions of the actual contract or other documents.

Exchange Controls

Petrobras

There are no restrictions on ownership of the common or preferred shares by individuals or legal entities domiciled outside Brazil.

The right to convert dividend payments and proceeds from the sale of shares into foreign currency and to remit such amounts outside Brazil may be subject to restrictions under foreign investment legislation which generally requires, among other things, that the relevant investments be registered with the Central Bank of Brazil. If any restrictions are imposed on the remittance of foreign capital abroad, they could hinder or prevent CBLC, as custodian for the common and preferred shares represented by the American Depositary Shares, or registered holders who have exchanged American Depositary Shares for common shares or preferred shares, from converting dividends, distributions or the proceeds from any sale of such common shares or preferred shares, as the case may be, into U.S. dollars and remitting the U.S. dollars abroad.

Foreign investors may register their investment under Law No. 4,131 of September 3, 1962 or Resolution No. 2,689. Registration under Resolution No. 2,689 affords favorable tax treatment to foreign investors who are not resident in a tax haven, as defined by Brazilian tax laws. See Brazilian Tax Considerations.

Under Resolution No. 2,689, foreign investors may invest in almost all financial assets and engage in almost all transactions available in the Brazilian financial and capital markets, provided that certain requirements are fulfilled. In accordance with Resolution No. 2,689, the definition of foreign investor includes individuals, legal entities, mutual funds and other collective investment entities, domiciled or headquartered abroad.

Under Resolution No. 2,689, a foreign investor must:

- appoint at least one representative in Brazil, with powers to perform actions relating to its investment;
- appoint an authorized custodian in Brazil for its investments;
- register as a foreign investor with the CVM; and
- register its foreign investment with the Central Bank of Brazil.

Securities and other financial assets held by a Resolution No. 2,689 investor must be registered or maintained in deposit accounts or under the custody of an entity duly licensed by the Central Bank of Brazil or the CVM. In addition, any transfer of securities held under Resolution No. 2,689 must be carried out in the stock exchanges or through organized over-the-counter markets licensed by the CVM, except for transfers resulting from a corporate reorganization or occurring upon the death of an investor by operation of law or will.

Holders of American Depositary Shares who have not registered their investment with the Central Bank of Brazil could be adversely affected by delays in, or refusals to grant, any required government approval for conversions of payments made in *reais* and remittances abroad of these converted amounts.

Annex III Regulations provide for the issuance of depositary receipts in foreign markets with respect to shares of Brazilian issuers. The depositary of the ADSs has obtained from the Central Bank of Brazil an electronic certificate of registration with respect to our existing ADR program. Pursuant to the registration, the custodian and the depositary will be able to convert dividends and other distributions with respect to the relevant shares represented by ADSs into foreign currency and to remit the proceeds outside Brazil. Following the closing of an international offering, the electronic certificate of registration will be amended by the depositary with respect to the

ADSs sold in the international offering and will be maintained by the Brazilian custodian for the relevant shares on behalf of the depositary.

In the event that a holder of ADSs exchanges such ADSs for the underlying shares, the holder will be entitled to continue to rely on such electronic registration for five business days after the exchange. Thereafter, unless the relevant shares are held pursuant to Resolution No. 2,689 by a duly registered investor, or a holder of the relevant shares applies for and obtains a new certificate of registration from the Central Bank of Brazil, the holder may not be able to convert into foreign currency and to remit outside Brazil the proceeds from the disposition of, or distributions with respect to, the relevant shares, and the holder, if not registered under Resolution No. 2,689, will be subject to less favorable Brazilian tax treatment than a holder of ADSs. In addition, if the foreign investor resides in a tax haven jurisdiction, the investor will be also subject to less favorable tax treatment. See Item 3. Key Information Risk Factors Risks Relating to Our Equity and Debt Securities and Brazilian Tax Considerations.

PIFCo

There are:

- no governmental laws, decrees or regulations in Cayman Islands that restrict the export or import of capital, including dividend and other payments to holders of notes who are not residents of the Cayman Islands, provided that such holders are not resident in countries subject to certain sanctions by the United Nations or the European Union, and

- no limitations on the right of nonresident or foreign owners imposed by Cayman Island law or PIFCo s Memorandum of Association to hold or vote PIFCo s shares.

Taxation relating to our ADSs and common and preferred shares

The following summary contains a description of material Brazilian and U.S. federal income tax considerations that may be relevant to the purchase, ownership and disposition of preferred or common shares or ADSs by a holder. This summary does not describe any tax consequences arising under the laws of any state, locality or taxing jurisdiction other than Brazil and the United States.

This summary is based upon the tax laws of Brazil and the United States as in effect on the date of this annual report, which are subject to change (possibly with retroactive effect). This summary is also based upon the representations of the depositary and on the assumption that the obligations in the deposit agreement and any related documents will be performed in accordance with their respective terms.

This description is not a comprehensive description of all of the tax considerations that may be relevant to any particular investor, including tax considerations that arise from rules of general application to all taxpayers or to certain classes of investors or that are generally assumed to be known by investors. **Prospective purchasers of common or preferred shares or ADSs should consult their own tax advisors as to the tax consequences of the acquisition, ownership and disposition of common or preferred shares or ADSs**.

There is no income tax treaty between the United States and Brazil. In recent years, the tax authorities of Brazil and the United States have held discussions that may culminate in such a treaty. We cannot predict, however, whether or when a treaty will enter into force or how it will affect the U.S. holders of common or preferred shares or ADSs.

Brazilian Tax Considerations

General

The following discussion summarizes the material Brazilian tax consequences of the acquisition, ownership and disposition of preferred or common shares or ADSs, as the case may be, by a holder that is not domiciled in

Brazil, also called a non-Brazilian holder, for purposes of Brazilian taxation and, in the case of a holder of preferred or common shares, which has registered its investment in preferred or common shares at the Central Bank of Brazil as a U.S. dollar investment.

Under Brazilian law, investors may invest in the preferred or common shares under Resolution No. 2,689 or under Law No. 4,131 of September 3, 1962. Investments under Resolution No. 2,689 afford favorable tax treatment to foreign investors who are not resident in a tax haven jurisdiction. The rules of Resolution No. 2,689 allow foreign investors to invest in almost all instruments and to engage in almost all transactions available in the Brazilian financial and capital markets, provided that certain requirements are met. In accordance with Resolution No. 2,689, the definition of foreign investor includes individuals, legal entities, mutual funds and other collective investment entities, domiciled or headquartered abroad.

Pursuant to this rule, foreign investors must: (1) appoint at least one representative in Brazil with powers to perform actions relating to the foreign investment; (2) complete the appropriate foreign investor registration form; (3) register as a foreign investor with the CVM; and (4) register the foreign investment with the Central Bank of Brazil.

Securities and other financial assets held by foreign investors pursuant to Resolution No. 2,689 must be registered or maintained in deposit accounts or under the custody of an entity duly licensed by the Central Bank of Brazil or the CVM. In addition, securities trading is restricted to transactions carried out in the stock exchanges or organized over-the-counter markets licensed by the CVM.

Taxation of Dividends

Dividends paid by us, including stock dividends and other dividends paid in property to the depositary in respect of the ADSs, or to a non-Brazilian holder in respect of the preferred or common shares, are currently not subject to withholding tax in Brazil.

We must pay to our shareholders (including holders of common or preferred shares or ADSs) interest on the amount of dividends payable to them, at the SELIC rate (the interest rate applicable to certain Brazilian government securities), from the end of each fiscal year through the date of effective payment of those dividends. These interest payments are considered as fixed-yield income and are subject to withholding income tax at varying rates depending on the length of period of interest accrual. The tax rate ranges from 15%, in case of interest accrued for a period greater than 720 days, to 22.5%, in case of interest accrued for a period up to 180 days. However, holders of ADSs and holders of common or preferred shares not resident or domiciled in tax haven jurisdictions (see Beneficiaries Residing or Domiciled in Tax Havens or Low Tax Jurisdictions) investing under Resolution No. 2,689 are subject to such withholding tax at a reduced rate, currently at 15%.

Taxation on Interest on Shareholders Equity

Any payment of interest on shareholders equity (see Memorandum and Articles of Incorporation of Petrobras Payment of Dividends and Interest on Shareholders Equity) to holders of ADSs or preferred or common shares, whether or not they are Brazilian residents, is subject to Brazilian withholding income tax at the rate of 15% at the time we record such liability, whether or not the effective payment is made at that time. In the case of non-Brazilian residents that are resident in a tax haven jurisdiction, the applicable withholding income tax rate is 25% (see Beneficiaries Residing or Domiciled in Tax Havens or Low Tax Jurisdictions). The payment of interest at the SELIC rate that is applicable to payments of dividends applies equally to payments of interest on shareholders equity. The determination of whether or not we will make distributions in the form of interest on shareholders equity or in the form of dividends is made by our board of directors at the time distributions are to be made. We cannot determine how our board of directors will make these determinations in connection with future distributions.

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Taxation of Gains

For purposes of Brazilian taxation, there are two types of non-Brazilian holders of ADSs or preferred or common shares: (1) non-Brazilian holders that are not resident or domiciled in a tax haven jurisdiction (see Beneficiaries Residing or Domiciled in Tax Havens or Low Tax Jurisdictions), and that, in the case of holders of preferred or common shares, are registered before the Central Bank of Brazil and the CVM to invest in Brazil in accordance with Resolution No. 2,689; and (2) other non-Brazilian holders, which include any and all non-residents of Brazil who invest in equity securities of Brazilian companies through any other means (including under Law No. 4,131 of 1962) and all types of investors that are located in tax haven jurisdictions. The investors identified in clause (1) above are subject to favorable tax treatment in Brazil, as described below.

According to Law nº 10,833, dated December 29, 2003, capital gains realized on the disposition of tangible assets located in Brazil, by non-Brazilian residents, whether or not to other non-residents and whether made outside or within Brazil, are subject to taxation in Brazil at a rate of 15% (a rate of 25% is applicable if realized by investors resident in a tax haven jurisdiction, i.e. a country that does not impose any income tax or that imposes tax at a maximum rate of less than 20%). We understand the ADSs do not fall within the definition of tangible assets located in Brazil for the purposes of this law, but there is still no pronunciation from tax authorities nor judicial court rulings in this respect. Therefore, we are unable to predict whether such understanding will prevail in the courts of Brazil.

The deposit of preferred or common shares in exchange for ADSs may be subject to Brazilian capital gains at the rate of 15% if the amount previously registered with the Central Bank of Brazil as a foreign investment in the preferred or common shares is lower than:

(1) the average price per preferred or common share on a Brazilian stock exchange on which the greatest number of such shares were sold on the day of deposit; or

(2) if no preferred or common shares were sold on that day, the average price on the Brazilian stock exchange on which the greatest number of preferred or common shares were sold in the 15 trading sessions immediately preceding such deposit. In such a case, the difference between the amount previously registered and the average price of the preferred or common shares calculated as above, will be considered a capital gain. Investors registered under Resolution No. 2,689 and not located in a tax haven jurisdiction are exempt from this type of taxation. The withdrawal of ADSs in exchange for preferred or common shares is not subject to Brazilian tax. On receipt of the underlying preferred or common shares, the non-Brazilian holder registered under Resolution No. 2,689 will be entitled to register the U.S. dollar value of such shares with the Central Bank of Brazil as described below in Registered Capital.

Non-Brazilian holders are not subject to tax in Brazil on gains realized on sales of preferred or common shares that occur abroad to non-Brazilian holders.

Non-Brazilian holders which are not located in a tax haven jurisdiction are subject to income tax imposed at a rate of 15% on gains realized on sales or exchanges of the preferred or common shares that occur in Brazil or with a resident of Brazil, other than in connection with transactions on the Brazilian stock, future or commodities exchanges. With respect to proceeds of a redemption or of a liquidating distribution with respect to the preferred or common shares, the difference between the amount effectively received by the shareholder and the amount of foreign currency registered with the Central Bank of Brazil, accounted for in *reais* at the commercial market rate on the date of the redemption or liquidating distribution, will be also subject to income tax at a rate of 15% given that such transactions are treated as a sale or exchange not carried out on the Brazilian stock, future and commodities exchanges.

Gains realized arising from transactions on the Brazilian stock, future or commodities exchanges by an investor registered under Resolution No. 2,689 who is not located in a tax haven jurisdiction are exempt from Brazilian income tax. Otherwise, gains realized on transactions related to the Brazilian stock, future or commodities exchanges are subject to income tax at a rate of 20%.

Therefore, non-Brazilian holders are subject to income tax imposed at a rate of 20% on gains realized on sales or exchanges of preferred or common shares that occur on the stock exchange unless such a sale is made by a non-Brazilian holder who is not resident in a tax haven jurisdiction and:

(1) such sale is made within five business days of the withdrawal of such preferred or common shares in exchange for ADSs and the proceeds thereof are remitted abroad within such five-day period; or

(2) such sale is made under Resolution No. 2,689 by registered non-Brazilian holders who obtain registration with the CVM.

In these two cases, the transaction will not be subject to taxation in Brazil. The gain realized is for tax purposes the difference between the amount in *reais* realized on the sale or exchange and the acquisition cost measured in *reais*, without any adjustment to account for inflation of the shares sold. The gain realized as a result of a transaction that occurs other than on the stock exchange will be the positive difference between the amount realized on the sale or exchange and the acquisition cost of the preferred or common shares, both such values to be taken into account in *reais*. There are reasonable grounds, however, to hold that the gain realized should be calculated based on the foreign currency amount registered with the Central Bank of Brazil, such foreign currency amount to be translated into *reais* at the commercial market rate on the date of such sale or exchange.

Any exercise of preemptive rights relating to the preferred or common shares will not be subject to Brazilian taxation. Any gain on the sale or assignment of preemptive rights relating to the preferred or common shares by the depositary on behalf of holders of the ADSs will be subject to Brazilian income taxation according to the same rules applicable to the sale or disposition of preferred or common shares, unless such sale or assignment is performed on the stock exchange by an investor under Resolution No. 2,689 who is not resident in a tax haven jurisdiction, in which case the gains are exempt from income tax.

There is no assurance that the current preferential treatment for holders of the ADSs and some non-Brazilian holders of the preferred or common shares under Resolution No. 2,689 will continue in the future.

Taxation of Foreign Exchange Transactions (IOF/Câmbio)

Under Decree No. 4,494 of December 3, 2002, the conversion into Brazilian currency of proceeds received by a Brazilian entity from a foreign investment in the Brazilian securities market (including those in connection with an investment in preferred or common shares or the ADSs and those under Resolution No. 2, 689) and the conversion into foreign currency of proceeds received by a non-Brazilian holder is subject to a tax on exchange transactions known as IOF/Câmbio, which is currently applicable at a zero percent rate in most transactions. However, according to Law No. 8,894 of June 21, 1994, the IOF/Câmbio rate may be increased at any time to a maximum of 25% by a decision of the Minister of Finance, but only in relation to exchange transactions carried out after the increase of the applicable rate.

Taxation on Bonds and Securities Transactions (IOF/Títulos)

Law No. 8,894 created the Tax on Bonds and Securities Transactions, or IOF/Títulos, which may be imposed on any transactions involving bonds and securities carried out in Brazil, even if these transactions are performed on the Brazilian stock, futures or commodities exchange. As a general rule, the rate of this tax is currently zero but the Brazilian government may increase such rate up to 1.5% per day, but only in relation to transactions carried out after the increase of the applicable rate.

Other Brazilian Taxes

There are no Brazilian inheritance, gift or succession taxes applicable to the ownership, transfer or disposition of preferred or common shares or ADSs by a non-Brazilian holder, except for gift and inheritance taxes which are levied by some states of Brazil on gifts made or inheritances bestowed by individuals or entities not resident or domiciled in Brazil to individuals or entities resident or domiciled within such states in Brazil. There are

no Brazilian stamp, issue, registration, or similar taxes or duties payable by holders of preferred or common shares or ADSs.

Tax on Bank Account Transactions (CPMF)

The *Contribuição Provisória sobre Movimentação Financeira* (Tax on Bank Account Transactions, or CPMF), is imposed on any debit to bank accounts. As a result, transactions by the depositary or by holders of preferred or common shares, which involve the transfer of Brazilian currency through Brazilian financial institutions, are subject to the CPMF tax at a rate of 0.38%. These transactions include situations where a non-Brazilian holder transfers the proceeds from the sale or assignment of preferred or common shares by an exchange transaction, in which case the CPMF tax will be levied on the amount to be remitted abroad in *reais*. If we have to perform any exchange transaction in connection with ADSs or preferred or common shares, we will also be subject to the CPMF tax. The financial institution that carries out the relevant financial transaction will be responsible for collecting the applicable CPMF tax.

Withdrawals from deposit accounts of Brazilian or non-Brazilian residents, for the acquisition of shares in public offerings registrated with CVM, but not in stock exchange, are subject to a zero percent CPMF tax rate, provided that the issuer is registered for negotiation of the shares in a stock exchange.

The CPMF will not be levied in the liquidation of stock acquisitions in public offers registered with the *Comissão de Valores Mobiliários* (Securities and Exchange Commission, or CVM), provided that the issuing company is listed in a stock exchange.

Beneficiaries Resident or Domiciled in Tax Havens or Low Tax Jurisdictions

Law No. 9,779 of January 1, 1999 states that, except for limited prescribed circumstances, income derived from transactions by a beneficiary, resident or domiciliary of a country considered a tax haven is subject to withholding income tax at the rate of 25%. Tax havens are considered to be countries which do not impose any income tax or which impose such tax at a maximum rate of less than 20%. Accordingly, if the distribution of interest attributed to shareholders equity is made to a beneficiary resident or domiciled in a tax haven jurisdiction, the applicable income tax rate will be 25% instead of 15%. Capital gains are not subject to this 25% tax, even if the beneficiary is resident in a tax haven jurisdiction. See Taxation of Gains.

Registered Capital

The amount of an investment in preferred or common shares held by a non-Brazilian holder who obtains registration under Resolution No. 2,689, or by the depositary representing such holder, is eligible for registration with the Central Bank of Brazil; such registration (the amount so registered being called registered capital) allows the remittance outside Brazil of foreign currency, converted at the commercial market rate, acquired with the proceeds of distributions on, and amounts realized with respect to dispositions of, such preferred or common shares. The registered capital for each preferred or common share purchased as part of the international offering or purchased in Brazil after the date hereof, and deposited with the depositary will be equal to its purchase price (in U.S. dollars). The registered capital for a preferred or common share that is withdrawn upon surrender of an ADS will be the U.S. dollar equivalent of:

- the average price of a preferred or common share on the Brazilian stock exchange on which the greatest number of such shares were sold on the day of withdrawal; or

- if no preferred or common shares were sold on that day, the average price on the Brazilian stock exchange on which the greatest number of preferred or common shares were sold in the 15 trading sessions immediately preceding such withdrawal.

The U.S. dollar value of the average price of preferred or common shares is determined on the basis of the average of the U.S. dollar/*real* commercial market rates quoted by the Central Bank of Brazil information system on that date (or, if the average price of preferred or common shares is determined under the second option above, the

average of such average quoted rates on the same 15 dates used to determine the average price of preferred or common shares).

A non-Brazilian holder of preferred or common shares may experience delays in effecting such registration, which may delay remittances abroad. Such a delay may adversely affect the amount, in U.S. dollars, received by the non-Brazilian holder. See Item 3. Key Information Risk Factors Risks Relating to Our Equity and Debt Securities.

U.S. Federal Income Tax Considerations

The statements regarding U.S. tax law set forth below are based on U.S. law as in force on the date of this annual report, and changes to such law subsequent to the date of this annual report may affect the tax consequences described herein. This summary describes the principal tax consequences of the ownership and disposition of common or preferred shares or ADSs, but it does not purport to be a comprehensive description of all of the tax consequences that may be relevant to a decision to hold or dispose of common or preferred shares or ADSs. This summary applies only to purchasers of common or preferred shares or ADSs who will hold the common or preferred shares or ADSs as capital assets and does not apply to special classes of holders such as dealers in securities or currencies, holders whose functional currency is not the U.S. dollar, holders of 10% or more of our shares (taking into account shares held directly or through depositary arrangements), tax-exempt organizations, financial institutions, holders liable for the alternative minimum tax, securities traders who elect to account for their investment in common or preferred shares or ADSs on a mark-to-market basis, and persons holding common or preferred shares or ADSs in a hedging transaction or as part of a straddle or conversion transaction.

Each holder should consult such holder s own tax advisor concerning the overall tax consequences to it, including the consequences under laws other than U.S. federal income tax laws, of an investment in common or preferred shares or ADSs.

Shares of our preferred stock will be treated as equity for U.S. federal income tax purposes. In general, for purposes of the U.S. Internal Revenue Code of 1986, or the Code a holder of an ADS will be treated as the holder of the shares of common or preferred stock represented by those ADSs, and no gain or loss will be recognized if you exchange an ADS for the shares of common or preferred stock represented by that ADS.

In this discussion, references to ADSs refer to ADSs with respect to both common and preferred shares, and references to a U.S. holder are to a holder of an ADS that:

- is a citizen or resident of the United States of America,
- is a corporation organized under the laws of the United States of America or any state thereof; or
- is otherwise subject to U.S. federal income taxation on a net basis with respect to the shares or the ADS.

Taxation of Distributions

A U.S. holder will recognize ordinary dividend income for U.S. federal income tax purposes in an amount equal to the amount of any cash and the value of any property we distribute as a dividend to the extent that such distribution is paid out of our current or accumulated earnings and profits, as determined for U.S. federal income tax purposes, when such distribution is received by the custodian, or by the U.S. holder in the case of a holder of common or preferred shares. The amount of any distribution will include the amount of Brazilian tax withheld on the amount distributed, and the amount of a distribution paid in *reais* will be measured by reference to the exchange rate for converting *reais* into U.S. dollars in effect on the date the distribution is received by the custodian, or by a U.S. holder in the case of a holder of common or preferred shares. If the custodian, or U.S. holder in the case of a holder of common or preferred shares, does not convert such *reais* into U.S. dollars on the date it receives them, it is possible that the U.S. holder will recognize foreign currency loss or gain, which would be ordinary loss or gain,

when the *reais* are converted into U.S. dollars. Dividends paid by us will not be eligible for the dividends received deduction allowed to corporations under the Code.

Subject to certain exceptions for short-term and hedged positions, the U.S. dollar amount of dividends received by an individual prior to January 1, 2011 with respect to the ADSs will be subject to taxation at a maximum rate of 15% if the dividends are qualified dividends. Dividends paid on the ADSs will be treated as qualified dividends if (i) the ADSs are readily tradable on an established securities market in the United States and (ii) the Company was not, in the year prior to the year in which the dividend was paid, and is not, in the year in which the dividend is paid, a passive foreign investment company (PFIC). The ADSs are listed on the New York Stock Exchange, and will qualify as readily tradable on an established securities market in the United States so long as they are so listed. Based on the Company s audited financial statements and relevant market and shareholder data, the Company believes that it was not treated as a PFIC for U.S. federal income tax purposes with respect to its 2004 or 2005 taxable year. In addition, based on the Company s audited financial statements and its current expectations regarding the value and nature of its assets, the sources and nature of its income, and relevant market and shareholder data, the Company does not anticipate becoming a PFIC for its 2006 taxable year. Based on existing guidance, it is not clear whether dividends received with respect to the shares will be treated as qualified dividends, because the shares are not themselves listed on a U.S. exchange. In addition, the U.S. Treasury has announced its intention to promulgate rules pursuant to which holders of ADSs and intermediaries though whom such securities are held will be permitted to rely on certifications from issuers to treat dividends as qualified for tax reporting purposes. Because such procedures have not yet been issued, it is not clear whether the Company will be able to comply with the procedures.

Distributions out of earnings and profits with respect to the shares or ADSs generally will be treated as dividend income from sources outside of the United States and generally will be treated as passive income (or, for taxable years beginning after December 31, 2006, as passive category income) for foreign tax credit purposes. Subject to certain limitations, Brazilian income tax withheld in connection with any distribution with respect to the shares or ADSs may be claimed as a credit against the U.S. federal income tax liability of a U.S. holder if such U.S. holder elects for that year to credit all foreign income taxes. Alternatively, such Brazilian withholding tax may be taken as a deduction against taxable income. Foreign tax credits may not be allowed for withholding taxes imposed in respect of certain short-term or hedged positions in securities or in respect of arrangements in which a U.S. holder s expected economic profit is insubstantial. U.S. holders should consult their own tax advisors concerning the implications of these rules in light of their particular circumstances.

Holders of ADSs that are foreign corporations or nonresident alien individuals (non-U.S. holders) generally will not be subject to U.S. federal income tax or withholding tax on distributions with respect to shares or ADSs that are treated as dividend income for U.S. federal income tax purposes unless such dividends are effectively connected with the conduct by the holder of a trade or business in the United States.

Holders of shares and ADSs should consult their own tax advisers regarding the availability of the reduced dividend tax rate in the light of the considerations discussed above and their own particular circumstances.

Taxation of Capital Gains

Upon the sale or other disposition of a share or an ADS, a U.S. holder will generally recognize gain or loss for U.S. federal income tax purposes. The amount of the gain or loss will be equal to the difference between the amount realized in consideration for the disposition of the share or the ADS and the U.S. holder s tax basis in the share or the ADS. Such gain or loss generally will be subject to U.S. federal income tax and will be treated as capital gain or loss. The net amount of long-term capital gain recognized by an individual holder before January 1, 2011 generally is subject to taxation at a maximum rate of 15%. Capital losses may be deducted from taxable income, subject to certain limitations.

A non-U.S. holder will not be subject to U.S. federal income tax or withholding tax on gain realized on the sale or other disposition of a share or an ADS unless:

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such gain is effectively connected with the conduct by the holder of a trade or business in the United States; or

such holder is an individual who is present in the United States of America for 183 days or more in the taxable year of the sale and certain other conditions are met.

Backup Withholding and Information Reporting

Dividends paid on, and proceeds from the sale or other disposition of, the ADSs or common or preferred shares to a U.S. holder generally may be subject to the information reporting requirements of the Code and may be subject to backup withholding unless the U.S. holder provides an accurate taxpayer identification number or otherwise establishes an exemption. The amount of any backup withholding collected from a payment to a U.S. holder will be allowed as a credit against the U.S. holder s U.S. federal income tax liability and may entitle the U.S. holder to a refund, provided that certain required information is furnished to the Internal Revenue Service.

A non-U.S. holder generally will be exempt from these information reporting requirements and backup withholding tax, but may be required to comply with certain certification and identification procedures in order to establish its eligibility for such exemption.

Taxation relating to PIFCo s notes

The following summary contains a description of material Cayman Islands, Brazilian and U.S. federal income tax considerations that may be relevant to the purchase, ownership, and disposition of PIFCo s debt securities. This summary does not describe any tax consequences arising under the laws of any state, locality or taxing jurisdiction other than the Cayman Islands, Brazil and the United States.

This summary is based on the tax laws of the Cayman Islands, Brazil and the United States as in effect on the date of this annual report, which are subject to change (possibly with retroactive effect). This description is not a comprehensive description of all of the tax considerations that may be relevant to any particular investor, including tax considerations that arise from rules of general application to all taxpayers or to certain classes of investors or that are generally assumed to be known by investors. **Prospective purchasers of notes should consult their own tax advisors as to the tax consequences of the acquisition, ownership and disposition of notes**.

There is no tax treaty to avoid double taxation between the Cayman Islands and the United States, the Cayman Islands and Brazil or Brazil and the United States. In recent years, the tax authorities of Brazil and the United States have held discussions that may culminate in such a treaty. We cannot predict, however, whether or when a treaty will enter into force or how it will affect the U.S. holders of notes.

Cayman Islands Taxation

Under current law, PIFCo is not subject to income, capital, transfer, sales or other taxes in the Cayman Islands.

PIFCo was incorporated as an exempted company under the laws of the Cayman Islands on September 24, 1997. PIFCo has received an Undertaking as to Tax Concessions pursuant to Section 6 of the Tax Concessions Law (1999 Revision) which provides that, for a period of twenty years from the date thereof no law hereafter enacted in the Cayman Islands imposing any tax or duty to be levied on income or on capital assets, gains or appreciation will apply to any of PIFCo s income or property and which is deemed to provide that no tax is to be levied on profits, income, gains or appreciations or which is in the nature of estate duty or inheritance tax shall be payable or in respect of shares, debentures or other of PIFCo s obligations, or by way of withholding of any part of a payment of principal due under a debenture or other of PIFCo s obligations.

No Cayman Islands withholding tax applies to distributions by PIFCo in respect of the notes. Noteholders are not subject to any income, capital, transfer, sales or other taxes in the Cayman Islands in respect of their purchase, holding or disposition of the notes.

Noteholders whose notes are brought into or issued in the Cayman Islands will be liable to pay stamp duty of up to C.I.250 on each note.

Brazil Taxation

The following discussion is a summary of the Brazilian tax considerations relating to an investment in the notes by a non-resident of Brazil. The discussion is based on the tax laws of Brazil as in effect on the date hereof and is subject to any change in Brazilian law that may come into effect after such date. The information set forth below is intended to be a general discussion only and does not address all possible consequences relating to an investment in the notes. **PROSPECTIVE INVESTORS SHOULD CONSULT THEIR OWN TAX ADVISERS AS TO THE CONSEQUENCES OF PURCHASING THE NOTES, INCLUDING, WITHOUT LIMITATION, THE CONSEQUENCES OF THE RECEIPT OF INTEREST AND THE SALE, REDEMPTION OR REPAYMENT OF THE NOTES OR COUPONS.**

Generally, an individual, entity, trust or organization domiciled for tax purposes outside Brazil (a Non-resident) is taxed in Brazil only when income is derived from Brazilian sources. Therefore, any gains or income paid by PIFCo in respect of the notes issued by it in favor of Non-resident noteholders are not subject to Brazilian taxes.

Interest (including original issuer discount, or OID, fees, commissions, expenses and any other income payable by a Brazilian resident to a non-resident) is generally subject to income tax withheld at source. Currently, the rate of withholding tax is 15% or such other lower rate as provided for in an applicable tax treaty between Brazil and another country. If the recipient of the payment is domiciled in a tax haven jurisdiction, as defined by Brazilian tax regulations, the rate will be 25%.

If the payments with respect to the notes are made by a Brazilian source, the noteholders will be indemnified so that, after payment of all applicable Brazilian taxes collectable by withholding, deduction or otherwise, with respect to principal, interest (including the OID) and additional amounts payable with respect to the notes (plus any interest and penalties thereon), a noteholder will retain an amount equal to the amounts that such noteholder would have retained had no such Brazilian taxes (plus interest and penalties thereon) been payable. The Brazilian obligor will, subject to certain exceptions, pay additional amounts in respect of such withholding or deduction so that the holder receives the net amount due.

According to Law nº 10,833, dated December 29, 2003, capital gains realized on the disposition of tangible assets located in Brazil, by non-Brazilian residents, whether or not to other non-residents and whether made outside or within Brazil, are subject to taxation in Brazil at a rate of 15% (a rate of 25% is applicable if realized by investors resident in a tax haven jurisdiction, i.e. a country that does not impose any income tax or that imposes tax at a maximum rate of less than 20%). We understand the notes do not fall within the definition of tangible assets located in Brazil for the purposes of this law, but there is still no pronunciation from tax authorities nor judicial court rulings in this respect. Therefore, we are unable to predict whether such understanding will prevail in the courts of Brazil.

Generally, there are no inheritance, gift, succession, stamp, or other similar taxes in Brazil with respect to the ownership, transfer, assignment or any other disposition of the notes by a Non-resident, except for gift and inheritance taxes imposed by some Brazilian states on gifts or bequests by individuals or entities not domiciled or residing in Brazil to individuals or entities not domiciled or residing within such states.

U.S. Federal Income Taxation

The following summary sets forth certain United States federal income tax considerations that may be relevant to a holder of a note that is, for U.S. federal income purposes, a citizen or resident of the United States or a domestic corporation or that otherwise is subject to Untied States federal income tax on a net income basis in respect of the notes (a U.S. holder). This summary is based upon the Code, its legislative history, existing and proposed U.S. Treasury regulations promulgated thereunder, published rulings by the U.S. Internal Revenue Service, or the

IRS, and court decisions, all in effect as of the date hereof, all of which authorities are subject to change or differing interpretations, which changes or differing interpretations could apply retroactively. This summary does not purport to discuss all aspects of United States federal income taxation which may be relevant to particular investors, such as financial institutions, insurance companies, dealers or traders in securities or currencies, regulated investment companies, tax-exempt organizations, certain short-term holders of notes, persons that hedge their exposure in the notes or hold notes as part of a position in a straddle or as part of a hedging transaction or conversion transaction for U.S. federal tax purposes, persons that enter into a constructive sale transaction with respect to the notes or U.S. Holder whose functional currency as defined in Section 985 of the code is not the U.S. dollar. U.S. holders should be aware that the U.S. federal income tax consequences of holding the notes may be materially different for investors described in the prior sentence.

In addition, this summary does not discuss any foreign, state or local tax considerations. This summary only applies to original purchasers of notes who purchase notes at the original issue price and hold the notes as capital assets (generally, property held for investment) within the meaning of Section 1221 of the Code.

PROSPECTIVE INVESTORS SHOULD CONSULT THEIR OWN TAX ADVISORS REGARDING THE TAX CONSEQUENCES OF INVESTING IN THE NOTES, INCLUDING THE EFFECTS OF FEDERAL, STATE, LOCAL, FOREIGN AND OTHER TAX LAWS.

Payments of interest

Payments of qualified stated interest (as defined below) on a note (including additional amounts, if any) generally will be taxable to a U.S. holder as ordinary interest income when such interest is accrued or received, in accordance with the U.S. holder s regular method of tax accounting. In general, if the issue price of a note is less than the stated redemption price at maturity by more than a *de minimis* amount, such note will be considered to have OID. The issue price of a note is the first price at which a substantial amount of such notes are sold to investors. The stated redemption price at maturity of a note generally includes all payments other than payments of qualified stated interest (as defined below).

In general, each U.S. holder of a note, whether such holder uses the cash or the accrual method of tax accounting, will be required to include in gross income as ordinary interest income the sum of the daily portions of OID on the note for all days during the taxable year that the U.S. holder owns the note. The daily portions of OID on a note are determined by allocating to each day in any accrual period a ratable portion of the OID allocable to that accrual period. In general, in the case of an initial holder, the amount of OID on a note allocable to each accrual period is determined by (a) multiplying the adjusted issue price, as defined below, of the note at the beginning of the accrual period by the yield to maturity of the note, and (b) subtracting from that product the amount of qualified stated interest allocable to that accrual period. U.S. holders should be aware that they generally must include OID in gross income as ordinary interest income for U.S. federal income tax purposes as it accrues, in advance of the receipt of cash attributable to that income. The adjusted issue price of a note at the beginning of any accrual period will generally be the sum of its issue price (generally including accrued interest, if any) and the amount of OID allocable to all prior accrual periods, reduced by the amount of all payments other than payments of qualified stated interest (if any) made with respect to such note in all prior accrual periods. The term qualified stated interest generally means stated interest that is unconditionally payable in cash or property (other than debt instruments of the issuer) at least annually during the entire term of a note at a single fixed rate of interest, or subject to certain conditions, based on one or more interest indices.

Interest income, including OID, in respect of the notes will constitute foreign source income for United sates federal income tax purposes and, with certain exceptions, will be treated separately, together with other items of passive income (or, for taxable years beginning after December 31, 2006, of passive category income), for purposes of computing the foreign tax credit allowable under the United states federal income tax laws. The calculation of foreign tax credits, involves the application complex of rules that depend on a U.S. holder s particular circumstances. U.S. holders should consult their own tax advisors regarding the availability of foreign tax credits and the treatment of additional amounts.

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Sale or disposition of notes

A U.S. holder generally will recognize capital gain or loss upon the sale, exchange, retirement or other disposition of a note in an amount equal to the difference between the amount realized upon such sale, exchange, retirement or other disposition (other than amounts attributable to accrued qualified stated interest, which will be taxed as such) and such U.S. holder s adjusted tax basis in the note. A U.S. Holder s adjusted tax basis in the note generally will equal the U.S. holder s cost for the note increased by any amounts included in gross income by such U.S. holder as OID and reduced by any payments other than payments of qualified stated interest on that note. Gain or loss realized by a U.S. Holder on the sale, exchange, retirement or other disposition of a note generally will be United States source gain or loss for United States federal income tax purposes unless it is attributable to an office or other fixed place of business outside the United States and certain other conditions are met. The gain or loss realized by a U.S. holder will be capital gain or loss, and will be long-term capital gain or loss if the notes were held for more than one year. The net amount of long-term capital gain recognized by an individual holder before January 1, 2011 generally is subject to taxation at a maximum rate of 15%.

Backup Withholding and Information Reporting

A U.S. holder may, under certain circumstances, be subject to backup withholding with respect to certain payments to that U.S. holder, unless the holder (i) is a corporation or comes within certain other exempt categories, and demonstrates this fact when so required, or (ii) provides a correct taxpayer identification number, certifies that it is not subject to backup withholding otherwise complies with applicable requirements of the backup withholding rules. Any amount withheld under these rules generally will be creditable against the U.S. holder s U.S. federal income tax liability. While Non-U.S. holders generally are except from backup withholding, a Non-U.S. holder may, in certain circumstances, be required to comply with certain information and identification procedures in order to prove entitlement to this exemption.

Non-U.S. Holder

A holder or beneficial owner of a note that is not a U.S. holder (a non-U.S. holder) generally will not be subject to U.S. federal income or withholding tax on interest received on the notes. In addition, a non-U.S. holder will not be subject to U.S. federal income or withholding tax on gain realized on the sale of notes unless, in the case of gain realized by an individual non-U.S. holder, the non-U.S. holder is present in the United States for 183 days or more in the taxable year of the sale and certain other conditions are met.

Documents on Display

Statements contained in this annual report regarding the contents of any contract or other document are not necessarily complete, and, where the contract or other document is an exhibit to the annual report, each of these statements is qualified in all respects by the provisions of the actual contract or other documents.

We are subject to the information requirements of the Securities Exchange Act of 1934, as amended, applicable to a foreign private issuer, and accordingly, we file or furnish reports, information statements and other information with the SEC. These reports and other information filed by us can be inspected at, and subject to the payment of any required fees, copies may be obtained from, the Public Reference Room of the SEC, 100 F Street, N.E., Washington, D.C. 20549. As a foreign private issuer, we were not required to make filings with the SEC by electronic means prior to November 4, 2002, although we were permitted to do so. Any filings we make electronically will be available to the public over the internet at the SEC s website at http://www.sec.gov.

Reports and other information may also be inspected and copied at the offices of the New York Stock Exchange, 20 Broad Street, New York, New York 10005. As a foreign private issuer, however, we are exempt from the proxy requirements of Section 14 of the Exchange Act and from the short-swing profit recovery rules of Section 16 of the Exchange Act, although the rules of the New York Stock Exchange may require us to solicit proxies from our shareholders under some circumstances. Our website is located at http://www.petrobras.com.br. The information on our website is not part of this annual report.

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PIFCo Senior Notes

PIFCo has issued three series of Senior Notes in the aggregate amount of U.S.$1,550.0 million. See Item 5. Operating and Financial Review and Prospects Liquidity and Capital Resources. The terms of each of these series of Senior Notes, and the material agreements, which set forth, their terms, are substantially similar and are summarized below.

Indentures

PIFCo issued each series of Senior Notes pursuant to an indenture between PIFCo, as the issuer, and The Bank of New York, as trustee. The terms of the indentures require PIFCo and its subsidiaries, among other things, to:

- pay all amounts owed by it under the indenture and the notes when such amounts are due, and perform each of its other obligations under the various transaction documents entered into by it in connection with the issuance of the notes;
- comply with all applicable laws and maintain all necessary governmental approvals;
- pay all uncontested taxes;
- preserve its existence and maintain our properties;
- maintain adequate insurance;
- maintain its books and records in accordance with U.S. GAAP;
- maintain an office or agency in New York for the purpose of service of process;