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CONSTRUCTION PROJECTS IN BRAZIL

ONE STOP SHOP

INFRASTRUCTURE

SUMMARY

CONSTRUCTION

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1. BRAZILIAN LEGAL SYSTEM

1.1. OVERVIEW

Brazil features a civil law system, although some contractual practices have been incorporating legal and judicial concepts more typical of common law systems. Both German and Italian legal systems highly influenced the Brazilian contractual and legal framework.

The Brazilian legal system, on the other hand, when it comes to private construction and engineering projects, is not highly regulated in contractual terms. The Brazilian Civil Code contains a few general provisions for less complex construction contracts, which in principle will not apply to more complex contracts, such as turnkey Engineering, Procurement and Construction (EPC) contracts.

The only contractual statutory obligation under Brazilian Law that will most certainly be applicable to any construction contract, regardless of its complexity, is the one set forth in Article 618 of the Brazilian Civil Code, which establishes a minimum 5-year warranty period for any defect relating to the soundness or safety of the construction.

As opposed to private construction contracts, public procurement and public contracts are strongly regulated, in accordance with Brazilian Law.

The new Public Procurement and Administrative Contract Law

The newest **Public Procurement and Administrative Contracts Act (Law No. 14,133/2021)**, very recently published on April 1, 2021, consolidated several rules on the subject, in addition to bringing innovations to the sector.

Although Law No. 14,133/2021 is immediately effective, its applicability is not yet mandatory, since several regulatory provisions there are still pending. As a matter of fact, the referred Law provides for an adaptation period, so that its application shall only become mandatory as of April 1, 2023.

The most relevant changes are discussed below:

Major changes in the bidding process

The first major change was the introduction of "Competitive Dialogue" as a new form of tendering. This procedure allows for dialogue between the public administration and private companies that intend to bid for administrative contracts. This type of procedure is important to allow the Public Administration to gather more qualified and accurate information on the deal it intends to enter into, especially when considering the contracting of technological products and services.

Another change that is worth mentioning was the inversion of the bidding phases: the financial evaluation (analysis and judgment of commercial proposals) shall now take place before the technical evaluation.

The incorporation of ancillary bidding procedures, which were already provided for in the State-owned Companies Law (Accreditation, pre-qualification, PMI, price registration system and bidder registration), was also an important change.

Finally, the creation of the National Portal of Public Contracts (PNCP) stands out, in which all acts relevant to the bidding process must be published.

Major changes in administrative contracts

As for the administrative contracts, one of the major changes relates to the new provision that requires the inclusion of the Risk Matrix, which must necessarily appear as an attachment to the contract.

Another major change is the express authorization for alternative dispute resolution clauses, such as arbitration and the Dispute Boards. Although arbitration has been broadly accepted, since the Arbitration Act is clear in acknowledging the method as a legitimate tool to solve controversies related to administrative contracts, Dispute Boards, on the other hand, are most certainly an important innovation, as they are not provided for in any other federal law.

It is also worth mentioning the provision that requires performance bonds in the form of insurance for large-scale works, with the possibility of the insurer taking over the execution and concluding the object of the contract, in the event of default by the contracted party.

Last but not least, the New Law also brought a new contracting model called "efficiency contract" for the provision of services and/or goods. The idea behind such model is to stimulate and allow for the reduction of expenses, remunerating the supplier based on a percentage of the generated savings.

1.2. KEY STATUTORY OBLIGATIONS AND REQUIREMENTS

Health and Safety

Health and Safety are governed by law and regulations spread across all federated entities in Brazil (Federal, State and Local). There is not a sole legislation regulating the subject.

Ministry of Labor Ordinance No. 3,214/1978 is the closest there is to a codification at Federal level. This Ordinance compiles technical notes for the work environment such as exposure to toxic chemicals, excessive noise levels, mechanical hazards, temperature or unhealthy conditions, which guidelines are enforced in all States.

Despite said compilation, there are other rules that shall be considered when a project is intended to be performed in Brazil. For instance, employers are required to purchase "Labor Insurance" on their payrolls based on the risk of the activities performed by their employees. The insurance rates may vary in accordance to the employer's performance (i.e. compliance to law, number of labor accidents, risk mitigation, supply of personal protective equipment) in comparison to its peer companies.

More recently, the Ministry of Labor enacted Ordinance No. 672/2021, which sets out the policies, programs, and conditions for occupational safety and health, especially regarding the procedures for evaluating personal protective equipment, as set forth in Regulatory Norm No. 6 (NR 06).

The examples above are restricted to the Federal Level. When it comes to State and Local Levels, complexity increases exponentially due to several other regulations. The major challenge is to comply with all regulations at different levels, so as to mitigate the risks, and consequently reduce contingencies.

Environmental Protection

The Brazilian Constitution sets forth the concurrent authority of the Federal, State, and Federal District Level to issue laws in environmental matters. The Federal Level is responsible for issuing general laws, while the States are responsible for supplementing the Federal law, or, in the absence of such law, for issuing general laws, according to their peculiarities. Local administrations, in turn, are also granted environmental legislative competence, especially when related to matters of local interest, and to supplement Federal and State legislation where appropriate.

In such context, Federal Law No. 6,938/1981 established the "National Environmental Policy" and made Environmental licensing mandatory throughout the National territory for activities that cause or may cause pollution or environmental degradation.

Even though the legislation – which imposes licensing – was enacted at Federal Level, such licenses are usually issued by State environmental agencies and are, thus, subject to State level laws and regulations. Hence, a project in the State of Bahia may have substantially different requirements than a similar project in the State of Paraná, for example.

According to CONAMA Resolution No. 237/1997, the environmental licensing procedure is composed of 3 (three) phases, in which the following licenses are issued:

Preliminary License *("Licença Prévia")*

It is the first stage of licensing, prior to the implementation of the project, in which the Licensing agency assesses the future location and conception of the enterprise, certifying its environmental feasibility and establishing the basic requirements for the next phases. Environmental studies such as EIA (Brazilian acronym of "Environmental Impact Assessment"), and its respective report, the RIMA (Brazilian acronym of "Environmental Impact Report"), EAS (Brazilian acronym of "Simplified Environmental Assessment") or RCA (Brazilian acronym of "Environmental Control Report") may be required at this stage.

Installation License *("Licença de Instalação")*

Once the initial concept and location are detailed and environmental protection measures are defined, the Installation License must be applied for, that authorizes the construction to begin, with the specifications contained in the approved plans, programs, and projects, including the environmental control measures and other conditions.

Operation License *("Licença de Operação")*

The Operation License authorizes the enterprise operation and must be applied for to the competent authorities after environmental agencies have verified the effectiveness of the environmental control measures taken, as set forth in the conditions defined in the previous licenses.

The Brazilian Constitution determines that conduct and activities which are considered harmful to the environment subject violators (individuals or legal entities) to criminal and administrative sanctions, apart from the obligation to repair the damage caused.

The aforementioned Law no. 6,938/1981 establishes that the polluter is obligated, regardless of guilt, to indemnify or repair the damage caused to the environment and to third parties, affected by the violating activity.

Federal Law No. 9,605/1998, in turn, establishes criminal and administrative sanctions arising from conduct and activities that are harmful to the environment. According to the Brazilian legislation, environmental crimes are among the few that can be imposed on legal entities, and the respective penalties range from heavy fines to temporary or permanent suspension of activities.

Licenses and Permits

In addition to the abovementioned Licenses, there are several Permits which may be required by different public entities depending on the type of each construction project. Here are some examples of permits usually required in Brazil:

1. Federal Technical Registry of IBAMA (Instituto Brasileiro do Meio Ambiente e dos Recursos Naturais Renováveis) – Certificate of company regularity; it may also be required at State Level;
2. Grant for Water Resources (when necessary);
3. Permit to operate an ambulatory and/or day-care centers;
4. Permit to Use Thermal Fogging for Mosquitoes;
5. Operation License for Concrete Plant, Materials Site, Industrial Plants and Main Construction;
6. Office and cafeteria operating license;
7. License to use and carry chainsaw (when necessary);
8. Authorization for mineral extraction and/or mining rights (when necessary);
9. Road Transport License for dangerous goods and special loads (when applicable);
10. License for use and storage of controlled/hazardous materials (fuel/service station, chemicals, flammables);
11. Operating permit for the use, handling and storage of (miscellaneous) construction materials;

12. Authorization for the Deposit of Solid, Organic and Non-Recyclable Waste;
13. Hazardous Waste Manifest (MTR); Import and transport licenses;
14. Forestry Origin Document (DOF);
15. Rural Environmental Registry (CAR).

Labor and Employment

Brazil has several and complex rules related to Labor Law. Both Labor rules and Labor Courts have been overprotective to employees for the last decades, and this seems to be one of the reasons that lead to unproductivity of Brazilian employees, especially in the secondary sector of the Brazilian economy, which obviously comes alongside with all the known labor insecurity customarily found in developing countries.

Since 2017, however, modifications in law and court decisions have been implemented, with the purpose to increase labor productivity, reduce costs and promote legal certainty.

Given the labor-intensive nature of the construction sector, authorities issued specific rules adapted to such particularity. For example, in a typical Engineering, Procurement and Construction (EPC) agreement, contractor may register the construction site as an "independent entity / separate company" with the competent State Commercial Registry, in order to limit and reduce tax and labor contingencies.

One distinguishing feature of Brazilian law regarding labor that directly impacts labor-intensive industries is the subsidiary liability that affects contracting parties. Considering the mixed nature of rights and obligations of the several stakeholders in an Engineering, Procurement and Construction (EPC) agreement, and since the Brazilian law and authorities have a limited understanding of such contracts, a thorough analysis of the project and the contracts governing any given project is necessary in order to adapt them to the already tested and well-known structures of the sector.

Anti-corruption and Bribery

Companies' accountability for corruption (and not only for the individuals) is still under improvement in Brazil. Its relevance has been consolidated in the Organization for Economic Cooperation and Development (OECD) Anti-Bribery Convention of December 17, 1997, which

establishes legally binding standards to criminalize bribery of foreign public officials in international business transactions and provides for a host of related measures that make this effective.

In this context, Law No. 12,846/2013, also known as the "Anti-Corruption Law", regulated by Decree No. 11,129/2022, brought some innovations to the Brazilian legal system, such as:

(a) Possibility of strict liability of companies (regardless of the existence of fault), as a result of acts harmful to the national or foreign public administration;

(b) Encouraged prevention for companies that count on an adequate Compliance Program; and

(c) Possibility of leniency agreements, benefiting those who cooperate with investigations of illicit acts, fostering the cooperation between companies and the Public Administration.

Under Law No. 12,846/2013, there is liability only for the public sector and not for private corruption. On the other hand, there are other provisions in the Brazilian legislation to curb corruption practices, such as:

(i) The Criminal Code (Legislative Decree No. 2,848/1940): corruption acts are included in the criminal sphere, such as crimes against the public administration, against the economic order and against the tax order. Both the Criminal Code and the Anti-Corruption Law impose liability for acts against foreign public administrations. The Criminal Code has specific provisions regarding active bribery and influence peddling in international business transactions. Money laundering or wrongdoing related to financial statements are punished by specific laws, such as the Tax Crimes Law and the Anti-Money Laundering Law.

(ii) The Administrative Misconduct Law (Law No. 8,429/1992 and Law No 14,230/2021): main instruments of repression of corruption for public officials;

(iii) The Public Officials Law (Law No. 8,112/1990): sets forth responsibilities for public officials who engage in practices related to corruption;

(iv) The Public Procurement and Administrative Contract Law (Law No. 14,133/2021): establishes rules for public biddings and contracts, and punishes irregularities practiced by suppliers and contractors; and

(v) The State-Owned Companies Law (Law No. 13,303/2016): establishes specific rules for state-owned companies in terms of corporate governance, public tenders and contracts, compliance programs and control by public entities.

It is important to mention that the Supreme Federal Court declared, on September 17, 2015, the unconstitutionality of political contributions from domestic or foreign companies to political parties or candidates.

Brazil has ratified several conventions related to corruption, including:

(i) The Convention on combating Corruption of foreign public officials in international Business Transactions of December 17, 1997, of the Organization for Economic Cooperation and Development (OECD) (Decree No. 3,678/2000);

(ii) The Inter-American Convention against Corruption (Decree No. 4,410/2002);

(iii) The United Nations Convention against Transnational Organized Crime (Decree No. 5,015/2004); and

(iv) The United Nations Convention against Corruption (Decree No. 5,687/2006).

Finally, during the "Car Wash Operation" and its developments, Brazil signed several cooperation agreements with other countries to fight corruption and bribery.

Tort Law

The Brazilian legal system has a broad civil liability regime that can be classified as contractual or extracontractual. Since the concept of tort comes from common law, it is not possible to transpose it exactly to Brazilian law, but it can be placed in the category of extracontractual civil liability governed by the Brazilian Civil Code (specifically, Title IX, Book I, Special Part).

Extracontractual civil liability is divided into two categories: (i) fault liability and (ii) strict liability.

The general rule on fault-based liability is established in Article 927 together with Articles 186 and 187 of the Brazilian Civil Code. They provide that anyone (company or individual) who, through an illegal act, causes damage to another is obligated to repair it. The concept of wrongful act is built on the notion of voluntary action or omission, negligence or recklessness that violates rights and causes damages. The general concept refers to the guilty and reasonable individual who, with his wrongful conduct, has harmed the rights or legally protected interest of another.

The damage can be both economic and non-economic *(dano moral).* Its quantification is set forth by its extent, including direct, indirect or consequential damages, loss of profit, loss of revenue and other related amounts.

The general clause on strict liability is established in Article 927, sole paragraph, of the Brazilian Civil Code, which states that the obligation to repair damages will exist, regardless of fault, in the cases specified by law or when the activity normally carried out by the person who caused the damage entails, by its nature, risk to the rights of others.

The definition of a risky activity was a task entrusted to the courts and to doctrinal research. The standards of this definition are set high and normally involve activities that employ manipulation of nuclear energy, radioactive material or explosives. The cases specified by law in which strict liability is applicable are traditionally threefold: (a) owner or holder of animals, (b) building and construction owners, and (c) inhabitants of buildings for damages caused by things that fall or are thrown from them (Articles 936, 937 and 938 of the Brazilian Civil Code).

Regarding construction and engineering projects, Article 937 above mentioned is the main concern. It expressly imposes that the owner of a building or construction is liable for the damages that result from its ruin if caused by lack of repairs that were manifestly needed. Outside this specific scenario, non-contractual liability in the construction field will fall under the general rule of fault liability.

Tax

Brazilian tax legislation is known as one of the most complex in the world, which imposes several difficulties on both domestic and international investors and contractors wishing to operate in the country.

Regarding construction services, it is worth mentioning the local "service tax" (Imposto sobre Serviços de Qualquer Natureza – ISSQN), levied based on the value of the services. ISSQN is usually levied at a rate of 2% to 5%. Certain local administrations, however, may determine ISSQN payments based on estimated calculations that consider the built surface area, the type of construction and the "market value" of the services – regime that is often disputed in Brazilian courts.

The assessable basis of ISSQN does not include, as a rule of thumb, the amount related to goods and materials produced by the service provider outside the construction site, which are subject, thus, to the State "Value-Added Tax on Goods and Services" (Imposto sobre Circulação de Mercadorias e Serviços – ICMS).

The revenue accruing from the execution by the management, contracting or subcontracting of construction works is also subject to "PIS-Pasep contribution" and "social security contribution" (Contribuição para o Financiamento da Seguridade Social – COFINS), at the rates of 0.65% and 3%, respectively.

Aside from that, employers in the construction industry shall also pay an "employer's social security contribution" on payroll, at a usual rate of 20%. Alternatively, the contribution on payroll, at the discretion of the taxpayer, may be replaced by another, calculated in accordance with a fixed percentage of gross revenue (Contribuição Social sobre a Receita Bruta – CPRB).

It shall be noted that construction companies usually create entities such as Special Purpose Vehicles (SPVs), in order to mitigate tax risks. SPVs can tax their income in accordance with the presumed profit method (available for companies with an annual gross revenue of under BRL 78 million), resulting in a lower overall tax burden. Depending on the costs and expenses incurred for the performance of the construction services, however, it may be opportune to opt for the actual profit method.

In respect to infrastructure construction companies, one of the most important incentives in the Brazilian legislation is the Special Regime of Incentives for Infrastructure Development - REIDI. In order to reduce the initial cost of construction and attract private capital, REIDI was instituted in Brazil, which, first, suspends the enforceability of PIS-Import and COFINS-Import – taxes mentioned above – and, second, transforms the suspension into a zero rate once the products are used or incorporated into the construction.

Brazilian legislation also provides for incentives relating to ISSQN and ICMS, individually granted to specific infrastructure projects after negotiation with governmental entities.

Considering that Federal, State and Local administrations have concurrent authority to issue laws in tax matters, it is not difficult to understand the number of possible conflicts that could arise from such a triple legal delegation of authority (both legal and territorial). In order to mitigate the risk of non-compliance with tax laws (Federal, State and Local), it is important to perform surveys regarding the feasibility of the project, taking into consideration also the geographic location – which can be decisive for the economic feasibility of the project, as Local Laws can impose a huge burden to the project.

2. CONSTRUCTION INDUSTRY IN BRAZIL

2.1. FINANCING

Brazil is currently going through a transformation in the financing industry for infrastructure projects.

Historically, (Federal, State and Local) administrations have been the main funders of these projects, for a number of reasons, including the high interest rates on sovereign debt, political instability and unsteady GDP growth.

In the last two decades, the main source of infrastructure financing in Brazil has been state-owned development banks, in particular the BNDES (*Banco Nacional de Desenvolvimento Econômico e Social).* According to a recent report of ANBIMA *(Associação Brasileira das Entidades dos Mercados Financeiros e de Capitais),* in 2017, BNDES was responsible for 73.2% of all long-term financing disbursements.

Brazilians' criticism of the BNDES (due to possible political influences on credit analysis) combined with the lowering of interest rates on Brazilian sovereign debt is causing a change in the financing of the infrastructure sector. The capital market for infrastructure in Brazil is still very incipient, but it is the hope for the financing of this sector.

In this sense, Law No. 12,431/2011 established the incentivized infrastructure debentures, which, among other aspects, set forth tax benefits for individuals investing in such debt notes, as a way to foster capital markets for infrastructure financing. In 2014, the incentivized infrastructure debentures accounted for BRL 1.83 billion in long-term financing, corresponding to less than 1% of deployed capital; in 2017, those debt notes corresponded to approximately BRL 22 billion. The tax benefits on the incentivized infrastructure debentures are in the process of being extended to legal entities as to provide additional market for such notes, and, consequently, more available funds to the industry.

Capital markets are more susceptible to market conditions, when compared to state-owned development banks. Hence, to make capital markets a financing source for Brazilian infrastructure, Brazil will have to provide investors with strong signals of economic growth, political stability, and serious commitment to balance its public finance.

Brazilian law recognizes different rights and collateral warranties in favor of funders and third parties who engage in the financing of construction and engineering projects. The different forms of project financing in Brazil consider several possibilities for the structuring of collateral warranties and third-party rights, including:

1. Pledge or fiduciary sale of shares and assets;
2. Pledge or fiduciary assignment of rights and receivables;
3. Corporate bank guarantees;
4. Parent company guarantees;
5. Mortgage or fiduciary sale of land and buildings;
6. Step-in rights; and
7. "Reserve of ownership" and "Fiduciary Alienation" ("Trust Receipt"), among others.

Depending on each asset type, said securities shall require prior registration with the relevant public registry, since Brazilian law does not recognize "blanket liens".

2.2. PROCUREMENT ARRANGEMENTS

Parties

Typical parties in construction and engineering projects in Brazil vary in accordance with the specific set up of each single project.

A typical project would involve a "project owner" *(dono da obra)*, that is either (i) a large company investing in the improvement of its assets or (ii) a "concessionaire" contracting the works for the implementation of the assets object of the "concession". For public procurements, the project owner may also be a state-owned company or a public entity (Federal, State or Local administrations).

On the "contractor's" side, there may be different kinds of contractors, depending on the project's particular characteristics and the procurement method chosen. There are usually the civil construction contractor, the "Design Team", the "System Supplier" and other key suppliers. In Engineering, Procurement and Construction (EPC) projects, the main suppliers will be integrated in a "consortium", or even as subcontractors of the "contractor".

Not rarely the "project owner" will make use of consultants to work as their inspection team or "owner's engineer". In some projects that role is carried out by an internal team of the "owner".

In Project Finance structures, the financing agents and lenders will often be involved during the construction contracts negotiation and may have liens and assignment rights under the contracts.

In public procurement projects, external Public Audit Offices *(Tribunais de Contas)* may be heavily involved in the audit of the contract and its amendments. Their participation has been posing some complex legal challenges in recent public projects in Brazil, especially in the necessary legal process of authorization of standards for public infrastructure tenders to take place.

Usually, consultants are hired during the development and implementation of a construction project. This will vary depending on the type and the size of the work. Regularly engineers, architects, and legal and financial advisors are engaged. Other experts may be required, such as geologists and environmentalists. Also, it is common to require assistance for import and export of goods and equipment, customs clearance and fiscal services.

In private projects, typical clauses would only allow any subcontracting by the "contractor" if previously approved by the "owner". Some clauses would include a limit to subcontracting without previous approval, additional requirements applicable only to some subcontractors depending on their scope and contract price value ("major subcontractors") or even a list of predetermined subcontractors. In public projects, Brazilian Legislation allows subcontracting only up to the limit previously set forth by the public administration. The idea is that a "substantial portion" of the works shall not be subcontracted. Under Article 122, paragraphs one to three, of Law No. 14,133/2021, the contractor shall submit to the public administration evidence of subcontractor's technical capacity. In addition, (i) public bidding rules may either provide conditions to subcontracting or forbid it and (ii) individuals and entities whose officers have links with the public contracting leading officer or entity are excluded from subcontracting.

Contractual Structures

Standard forms of contracts are historically not frequently applied in construction projects in Brazil. Only recently, possibly as a result of a rearrangement of the market forces, with a deeper involvement of foreign companies in the "contractor's" side, standard forms are becoming more usual. From our experience, the FIDIC Rainbow (particularly the Silver Book) is the one more widely applied form in Brazil.

Depending on risk allocation, contract price, number and sophistication of the parties, the most common structures adopted in Brazil are the Engineering, Procurement and Construction (EPC) contract, the Engineering, Procurement and Construction Management (EPCM) contract and the Design-bid-build (DBB) contract.

Recently, Brazilian companies have also shown interest in adopting more collaborative contractual structures, especially due to the uncertainties that still impact the Brazilian market. The growing acceptance of the "Alliance Agreement" deserves special mention, with the publication in 2016 of the first edition of the "FAC-1 – Framework Alliance Contract", the first standard form of Framework Alliance Contract.

In their turn, public procurement procedures in Brazil for many years were based on several different laws. The general bidding rule was composed of Law No. 8,666/1993, complemented by Law No. 10,520/2002, which specifically regulates the reverse auction (pregão) bidding modality, as well as Law No. 12,462/2011, which provides special bidding rules for some public categories and events. However, new Brazilian public procurement general legislation was enacted under Law No. 14,133, in force since its publication date on April 1, 2021. In addition to its immediate effectiveness, it was established that the new law will coexist for two years with the above-mentioned laws of the previous procedure. During this period, the public administration may choose to apply one of the two regimes, the previous or the most recent, according to its preference, as provided in Article 191 of Law No. 14,133/2021.

Private procurement procedures in Brazil do not impose particular restrictions to the parties other than legal principles applicable to contracts in general.

Payment Conditions

The Brazilian legal system does not provide specific legislation relating to payment in the construction industry. The payment conditions will therefore be subject to general commercial rules set forth in the Brazilian Civil Code and contractual provisions.

For public projects, Public Audit Offices (Tribunais de Contas) will audit payments made by the public administration. They have some specific understandings on what can constitute payment wrongdoings in the public sector. It is important to be aware of such understandings.

Brazilian legislation does not have any specific provisions regarding "pay-when-paid" or "pay-if-paid" clauses. That does not mean that such conditions may be "bullet proof" under our legal system. Brazilian law establishes a statutory duty for both parties to act in good faith. It also provides that a party cannot act maliciously to prevent a contractual condition from occurring and so benefit from that act. For those reasons, any attempt to adopt these kinds of provision will only be sound if the subcontractor is effectively granted the right to seek for its rights under the contract. If specific clauses or the actual behavior of the party prevent the subcontractor from seeking its rights that may easily be considered void or null under our legal system.

Although this can bring some legal challenges, this sort of provisions is not totally rare in our contractual practices. Recent research made by our firm on this subject showed that our courts still have not had the opportunity to form a strong precedent on such matter.

Moreover, it is not uncommon to have retention clauses as a form of performance bond. The existence of such retentions will therefore be related to the specific system of contract performance guarantees agreed in the contract. If, for instance, the contractor is obliged to provide a Performance Bond, then a retention provision will not make much sense.

Usually, this provision establishes a fixed percentage of each payment to be retained by the employer until the final delivery of the project by the contractor.

Securities and Bonds

Different kinds of securities are used in the Brazilian context of construction projects. As a guarantee of the "contractor's" performance, the more typical one is the Performance Bond. Less commonly, but also possible for this same purpose, parties make use of first demand bank guarantees. Such Performance Guarantees tend to be in full force and effect until (at least) the provisional acceptance of the works. In some cases, after applying a percentage reduction, such guarantees remain in force until the final acceptance of the works.

Advance Payment Bonds or Bank Guarantees are commonly used as guarantees of advance payments made by the employer before the execution of the works. Although it depends on how the main contract is negotiated, such guarantees tend to be returned to the contractor when all advance payment has been fully compensated by the execution of the works.

Parent Company Guarantees may also be issued in the context of negotiations; however, in our experience, they are likely to be replaced by Insurance or Bank Guarantees.

In public procurement projects, the competent public authority, in each case, as provided for in the public bidding rules, may require the submission of a guarantee for the execution of the works. The contractor may choose one of the following types of guarantees: (i) retention *(caução)*, in the form of cash or public debt bonds, (ii) performance bond *(seguro-garantia)*, (iii) bank guarantee (Article 96 of Law 14,133/2021).

The guarantee may be up to 5% of the initial value of the public procurement contract of works, services, and supplies, and this percentage may be increased up to 10%, provided that is justified after analysis of the technical complexity and risks involved (Article 98 of Law 14,133/2021).

When contracting large-scale engineering works and services, the competent public authority may require a guarantee in the form of a performance bond (seguro-garantia), in a percentage up to 30% of the initial value of the contract. In addition, the public bidding rules may require that, in the event of default by the contractor, the insurer is obliged to undertake ("step-in") the performance of the contract and conclude its scope (Articles 99 and 102 of Law 14,133/2021).

Insurance

Brazilian law imposes mandatory Insurance to be contracted and maintained for construction-related projects, as follows:

(a) Civil liability for real estate contractors of urban zone constructions with respect to bodily injury and physical damage injuries and property damage, during all the construction period;

(b) Guarantees of the real estate developer and builder, until construction is complete;

(c) Borrower's payment guarantees related to construction, including real estate obligations; and

(d) Insurance against fire or total/partial destruction of buildings (Article 1,346 of Brazilian Civil Code).

Additionally, the following non-compulsory Insurance is usually required within the scope of construction projects:

1. Engineering risks ("All Risks");
2. Third parties' civil liability ("OCC/IM");
3. Miscellaneous risks insurance regarding mobile and stationary equipment;
4. Bodily injury, physical damage and life coverage for builder's employees; and
5. Environmental risks.

Nevertheless, the parties may also agree on other insurance policies that may serve the interests of both, especially in the context of highly complex infrastructure projects.

Liability and Liquidated Damages

Liquidated delay damages are very common provisions in Brazilian contractual praxis. Such clauses are usually upheld by our courts to the extent that they are not considered abusive but may exceptionally be challenged if, for example, the actual LD amount is clearly excessive in relation to the contract value.

Regarding general liability, almost every construction contract in Brazil would contain a "limitation of liability clause", establishing caps or even excluding the party's liability under certain circumstances. Such clauses may also be subject to "carve outs", in which case the limitations do not apply, such as "gross negligence" and "willful misconduct".

Despite its common use, the fact is that this sort of provision may still face some legal challenges to be fully upheld in court, for different reasons. First, some legal concepts clearly imported from other legal systems, such as "indirect loss" and "gross negligence" do not have a clear conceptual parallel in our legal system, which may bring some interpretation uncertainty. Additionally, considering that our Civil Code does not set out any statutory provision clearly allowing for "limitation clauses", it is possible that the Courts may be reluctant to acknowledge such limitations, in specific cases.

For that reason, it is our understanding that, in Brazil, "limitation of liability clauses" is more likely to be better construed and maintained in the context of arbitration procedures, rather than in judicial courts.

Claims

Private construction contracts in Brazil generally provide well-defined procedures whenever a party intends to submit a claim for the reimbursement of additional costs, or to request extension of time in order to comply with its obligations, or to demand any other adjustment regarding the contract.

Contracts normally associate both rights to a previous procedure of giving notice. These provisions also determine a specific time period which, if not complied with, would result in the loss of the party's right to claim or the claim itself.

Brazilian courts do not generally recognize the validity of these provisions (both in private and in public procurements). Pursuant to Article 192 of the Brazilian Civil Code, parties cannot agree on a different statute of limitations than the period provided by law. The understanding is that the statute of limitations is a matter of public policy. The discussion, however, remains as to whether such provisions could be acknowledged as "decadência", that is, the loss of the right itself, which may be acceptable in view of Article 211 of the Brazilian Civil Code.

Regarding the timeframe for the prescriptive period, recently the Superior Court of Justice decided that for claims arising from a contractual relationship, the prescriptive period would be of 10 (ten) years. There is still, however, a minor line of interpretation inclined to the understanding that the period should be of 3 (three) years, which despite being worth mentioning, is unlikely to prevail.

Due to these discussions, we frequently recommend the filing of a specific lawsuit provided under the Brazilian procedure law that tolls the prescriptive period *(protesto interruptivo de prescrição)*.

Moreover, conditioning a party's right to a notification procedure is also not generally accepted by Brazilian courts. There are, nonetheless, some exceptions, normally connected to the party's previous behavior, the principle of good faith and any principles derived from that (estoppel, for instance).

Termination

Termination of private contracts is governed by Chapter II, Title V, Book I, of the Special Part of the Brazilian Civil Code. In general, the private contracts can be terminated for three (3) different reasons:

(a) negligent non-performance, in which event the contract may be unilaterally or mutually terminated. The defaulting party shall be liable for damages caused to the other party, pursuant to Article 475 of the Brazilian Civil Code;

(b) voluntary non-negligent non-performance, in which event the contract may be unilaterally or mutually terminated, especially by convenience of one or both parties. If it is unilateral, the termination for convenience, in the event that a contract due to its type requires substantial investments, will only take effect after the expiration of a period of time compatible with the amortization and type of such investments reasonably made by the other party to perform the contract (Article 473, sole paragraph, of the Brazilian Civil Code); and

(c) involuntary, non-negligent non-performance, in which event the contract is lawfully terminated, especially in case of force majeure events. If the force majeure event occurs during any extension of time imputable to the "contractor", the latter may not invoke such event to avoid the liabilities related to the non-performance of the contract.

In addition, under Article 478 of the Brazilian Civil Code, in time-deferred or continued performance contracts, if the performance of one of the parties becomes excessively onerous, with extreme advantage given to the other party, due to extraordinary and unforeseeable events, the debtor may request the contract termination.

Public construction contracts, in turn, cannot be terminated due to the convenience of the contractor. Termination due to non-performance of obligations attributed to the Public Administration, as well as to force majeure events, must be operated through specific administrative process.

Disputes

The Brazilian legal system offers a few mechanisms of dispute resolution. Their use varies according to the type of contract entered by the parties. While disputes related to low budget and ordinary lump sum agreements, for example, tend to be taken to the state courts, complex agreements, such as Engineering, Procurement and Construction (EPC) and other FIDIC types, tend to be subject to arbitration.

The Brazilian Arbitration Act, in this sense, has recently reached the 25-year milestone and is an attractive alternative for dispute resolution in Brazil. It suffices to note that São Paulo is among a handful of cities around the globe where the International Chamber of Commerce has an office prepared to administer arbitration proceedings. Further, there are also very well reputed Brazilian arbitration chambers, such as the Center for Arbitration and Mediation of the Chamber of Commerce Brazil-Canada (CAM-CCBC), that provide excellent administration services to courts and parties.

Nonetheless, there have been some court of justice decisions recently that set aside some arbitration awards. One dispute in particular has been in the spotlight over the past year. In a nutshell, the Court of Appeals of the State of São Paulo set aside an award on the grounds that it was not sufficiently reasoned and that parties had not had the same opportunities to be heard during the proceedings.

In spite of this recent decision, we do not believe that the enforceability of the arbitration award or the arbitral device will be jeopardized. The Brazilian Arbitration Act does provide for an interplay between courts of justice and arbitration and the recent decision did not cross the lines set forth by law.

Brazil also counts on mediation, regulated by the Brazilian Mediation Act No. 13.140 of 26 June 2015, but studies have shown that this procedure is not so common in the infrastructure field.

Finally, and perhaps the most exciting news in this regard, is the visibility brought to Dispute Boards. The city of São Paulo passed Law No. 16,873/2018, which recognizes the use of Dispute Boards as a mechanism of dispute resolution, in its purest essence, for administrative contracts. This new piece of legislation has already echoed positively in the various academic and professional fields and is already spreading to other States and the Federal Level. Dispute Boards are an excellent remedy for the overwhelming planning deficiencies that plague public administration contracts, especially those involving civil works and infrastructure. A partner of our firm was responsible for drafting the first version of Law No. 16,873/2018.

Along with the new legislation, many public employers have inserted Dispute Board clauses in their contracts. New case law has also raised the Dispute Boards to a safer stage, thus encouraging employers and contractors to make use of the method. It is still in its beginning, but the expectations are high.

In that context, it is important to stress that the new Public Procurement and Administrative Contract Law (Law No. 14,133/2021) has expressly set forth the possibility for public entities to engage in alternative dispute resolution procedures, such as arbitration and dispute boards.

Although construction and engineering disputes are typically resolved by state courts, arbitration, dispute boards and mediation, Brazil does not count on adjudication procedures such as those implemented in England.

Multi-party disputes are also common in Brazil, especially with the state courts. Multi-party arbitrations, however, tend to be viewed with more parsimony, as they usually depend on a jurisdiction examination regarding the extension of the arbitral clauses.

As per the liability between multiple parties, it tends to vary from one case to another, as the cases have their own particularities. Judges and Arbitrators tend to assign liability to the Parties as a proportion of their faults.

3. OUTLOOK FOR THE BRAZILIAN CONSTRUCTION INDUSTRY

The Brazilian construction and infrastructure sector seems to be starting a new cycle of growth after its true devastation in the last years. The companies, controlled by Brazilian shareholders, which played a central role not only as contractors but also as investors and concession holders in the main projects in our country, lost their ability to invest or to be financed, due to the impact of the "Car Wash Operation", but have now returned to their original roots, regaining importance while acting as pure contractors. The change opened space for the entrance of foreign groups, both as investors and contractors. Foreign companies are being strongly stimulated by the Brazilian government to take part in all kinds of projects in the country's agenda of Public Auctions.

Brazil is an open arena for new groups to occupy the space left by the former leading companies. That poses many opportunities but also some challenges. One of the main challenges is to assure the new entrants with the legal certainty needed to operate in our market. Even though there have been some improvements on this matter there is still a long path to go. Therefore, knowing Brazil's legal complexity will be essential for any company interested in doing construction projects in Brazil, which is still recovering from one of the severe recessions of its history.

Infrastructure is still very necessary and a priority for Brazil.

A survey conducted by the Brazilian Association of Infrastructure and Basic Industries (Abdib) indicates that between 2019 and 2021, 115 auctions were held in the infrastructure sector, which generated R$ 125 billion in grants and expect more than R$ 500 billion in investments.

Projected investment in Brazil's infrastructure sector is expected to reach 188.1 billion reais in 2022. The main targets are power (R$ 81.7 billion), transportation (R$ 36.7 billion) and telecommunications (R$ 33.5 billion).

Additionally, 50 airports concessions were planned by the Federal Government and other Public-Private Partnerships (PPP) projects are under analysis by the Public Audit Office *(Tribunal de Contas)*.

However, the amount invested does not exceed what is required to fill the gap left by the last few years, but the deliveries reinforce the urgency to modernize Brazil's infrastructure and growth.

Renewable energy has been the one sector receiving more investment in the past years, in particular because of the stronger regulation of the sector and of new power sources, i.e., wind and solar photovoltaic energy.

The Brazilian construction market, although traditionally inclined to more conservative approaches, seems to have reached a turning point in the past few years, and is showing to have opened the doors for innovation and the use of new technologies. Here are some cases in which we can foresee transformation in Brazil:

(a) Digitization will decrease the amount of paperwork exchanged among the Parties; workflows will increase significantly not only for sharing official documents, but also for obtaining approvals with legal enforcement;

(b) Drones will help monitor and measure the physical progress of the Projects;

(c) Errors and unproductivity will be easier to identify, monitor and charge due to digitalization;

(d) Experts will have easier access to Project data due to digitalization, hence disputes will be more accurate or even prevented;

(e) The Internet of Things (IoT) will improve productivity and safety on sites;

(f) Smart contracts will expedite simple and procedure contracts in procurement departments; and

(g) Building Information Modelling will significantly improve risk analyses and planning of new Projects.

OUR FIRM

OUR FIRM

Toledo Marchetti Advogados was created to be the leading law firm in Brazil specializing in providing integrated strategic legal services exclusively for the infrastructure and construction market.

And this is because, unlike the traditional model, each one of our practices is deeply committed to the market and to our clients' business, whether they are investment funds, investor groups, concessionaires, owners, multilateral organizations, financing companies, construction companies, among others.

To carry out this work, we have brought together professionals with more than 20 years of experience.

ACKNOWLEDGMENTS

Our work and our strategic focus have been acknowledged and awarded by important national and international legal publications.

These awards distinguish us and motivate us to continue to offer excellent service, with the guarantee of our commitment that the firm will always be a reference in the market.

Chambers AND PARTNERS

LEADERS LEAGUE

WHO'S WHO LEGAL WWL

análise ADVOCACIA 500

LACCA APPROVED

The LEGAL 500

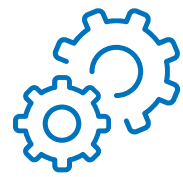
INFRASTRUCTURE CYCLE

Toledo Marchetti Advogados understands infrastructure from a cyclical perspective, as investments mature and develop.

We see the "Infra Cycle" in 3 major phases, in which we have specific solutions for the most varied needs:

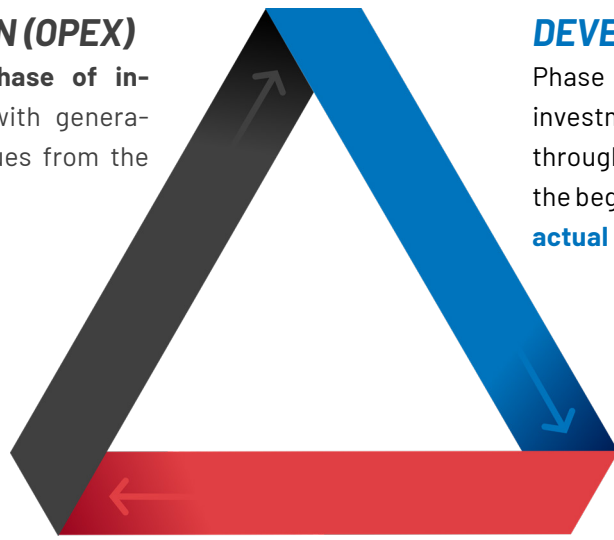
OPERATION (OPEX)

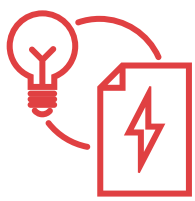
Maturation phase of investments with generation of revenues from the asset



DEVELOPMENT

Phase that starts with the investment decision, going through all the **planning** until the beginning of the **project's actual implementation**





IMPLEMENTATION (CAPEX)

The most cost-sensitive phase, which involves the execution of the project implementation contracts and the performance of the work until the **asset operation starts**

EXPERTISE & TEAM

To create and deliver the solutions, we set up teams customized for each need.

For this integrated performance, the office brings together professionals able to act, within the segment of infrastructure and construction, in the following areas of expertise:

CONTRACT ADMINISTRATION

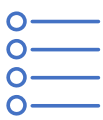
ENVIRONMENTAL AND CLIMATE CHANGE

ESG
ENVIRONMENTAL, SOCIAL & CORPORATE GOVERNANCE

COMPLIANCE / ANTI-CORPRUPTION

STRATEGIC LITIGATION

ARBITRATION AND DISPUTE RESOLUTION



PUBLIC AND REGULATORY LAW

TAX AND CUSTOMS LAW

CONSTRUCTION PROJECTS

CORPORATE AND M&A

LEGAL MANAGEMENT SOLUTIONS

INSURANCE AND GUARANTEES

DIFFERENT MARKETS

For Toledo Marchetti Advogados, the "Infra Cycle" works as an investment tool, and is used by the firm to deliver legal solutions to different markets:

POWER

RAILROADS

HIGHWAYS

AIRPORTS

PORTS

OIL AND GAS

URBAN MOBILITY

TELECOM

BASIC SANITATION

SOCIAL INFRASTRUCTURE (PRISONS, SCHOOLS, HOSPITALS)

FORESTS AND PARKS

SMART CITIES (GREEN INFRASTRUCTURE)

INDUSTRIAL PLANTS

ONE STOP SHOP

INFRASTRUCTURE

TOLEDO MARCHETTI

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