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US Investors Stand To Benefit From Brazil's New Forex Law

By **Jorge Kamine and Juliana Pimentel** (April 1, 2022)

As was evident in a recent presentation by Martha Seillier, Brazil's Special Secretary for Investment Partnerships Program, at the LatAm Energy and Infrastructure Conference, the pipeline of investment opportunities in Brazilian energy and infrastructure projects will continue to be robust.

Seillier cited 137 auctions and concessions with expected investments of up to \$166 billion. There are currently nine energy-generation assets, and four transmission line assets being auctioned, totalizing \$8.46 billion in investments. There are also two transmission auctions planned for 2022. The privatization of Eletrobras, Brazil's state-owned energy company, will also bring several opportunities for investors.

We see that the investment partnership program is on track to continue attracting private sector investors, with a particular focus on international investors, to the country's infrastructure sector.

However, two of the key challenges for U.S.-based investors looking at opportunities in Brazil have been the almost exclusively local-currency denominated offtake contracts and outflows to offshore parties of withholding tax and cash distributions. The risks associated with foreign exchange may be resolved with pending legislation that addresses the withholding tax issue.

On Dec. 30, 2021, Brazil's New Foreign Exchange Law was passed, setting forth a legal framework for the foreign exchange market. The changes set forth by the new forex law have answered long-standing concerns that have been expressed for some time by many U.S. investors and also some European investors, especially in the energy sector.

One of the most relevant changes brought about by the new forex law is the prospect for payments in foreign currency and the indexation of contracts in foreign currency. In the past, counterparties residing in Brazil had to stipulate payments in Brazilian reals except in a few cases permitted by law.

This represented a challenge for infrastructure companies to access the international debt market since the revenues arising from tariffs or offtake contracts — power purchase agreements, or PPAs, and provision of service contracts — had to be denominated in Brazilian reals. Thus, the financing of these companies was restricted to the local market in Brazilian reals most of the time to avoid mismatching between revenues and debts.

With this change, the new forex law is expected to improve the foreign investment environment for capital markets and direct investment, including long-term investments, especially for infrastructure projects. It is also likely to benefit large exporters in the electricity sector, especially energy-intensive ones, because of the ability to balance costs with their foreign currency revenues.

This change to the legal framework could also positively affect the availability of long-term financing of infrastructure projects — including funding for electricity, green hydrogen, port and highway projects — by substantially expanding the potential sources that were



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previously limited to providing most funding in foreign currency because of the risks associated with currency depreciation over the life of these projects.

These new potential funding sources include several multilateral organizations, credit agencies, development banks, international commercial banks and foreign investment funds.

An additional key provision is that with the new forex law, electric generation plants with power greater than 5,000 kilowatts will be able to enter into PPAs with energy consumers considered exporters.

Though this law has excellent potential to increase Brazil's competitiveness, there are still two unanswered issues that we will be closely monitoring before the law goes into effect on Dec. 31.

- There is still a lack of clarity on the exact definition of the concept of exporters, which could lead to uncertainties about the characteristics of the energy buyer able to enter into a contract with payment in foreign currency; that is if 100% of what is produced must be destined for exporting or if having any percentage of its production will suffice to qualify the buyer as an exporter.
- There are still questions whether there is a need for the energy acquired under the PPA in foreign currency to actually be used to produce the goods that will be exported to access the provisions of the new forex law. In addition, how will this be regulated since energy is a fungible good?

Regardless of the points mentioned above, we expect the new forex law will be an improvement to the previous framework. It arrives at a good time, expanding the possibility of financing for the government's ambitious infrastructure pipeline of new concessions for ports, airports, highways and railways, in addition to several projects in the energy sector.

This change to the legal framework has enormous potential to positively affect the availability of long-term financing of infrastructure by substantially expanding the potential sources that were limited to providing most funding in foreign currency — U.S. dollars — because of the risks associated with currency depreciation over the investment life of these projects.

For example, energy generators will have the possibility of accessing international financing, an option for the traditional local lenders such as the National Bank for Economic and Social Development. The funding of generation projects in U.S. dollars or euros will allow the alignment between financing and energy sales contracts, generating a hedging advantage.

We expect the new forex law will facilitate negotiations and reduce bureaucracy for foreign investments in Brazil at a time when investors are looking for projects with environmental, social and governance responsibility, placing Brazil in a good position to attract investments in the area of renewable energy.

Beyond the opportunities discussed, we believe that these changes signal that despite all

political and economic uncertainties, Brazil's energy sector can still offer interesting opportunities. Especially if, in the end, the main criterion for granting credit is the quality of the offtaker of projects.

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