Lenders Fear Environmental Liability in Brazil

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I. INTRODUCTION

A decision rendered by the Brazilian Superior Court of Justice on late 2009 was not supposed to attract much attention of lenders since the case was related to a claim for the remediation of environmental damages allegedly caused by a hardware manufacturer in a mangrove. No financial institution was involved in the case.

But the court went much farther than expected in stating that "for the purpose of establishing the chain of causation in an environmental damage, equivalent liability attaches to those who acted, those who did not act when they were supposed to do so, those who have failed to act, those who did not care about others acting, those who financed what others did, and those who benefited from what others did."

Following this decision, two class actions were filed in 2011 by the Federal Prosecutors' Office against Banco da Amazônia S.A. and Banco do Brasil claiming that the banks had failed to comply with Brazilian environmental laws in financing cattle raising on lands located in the Amazon Region. Federal Prosecutors asserted that, without that credit, the allegedly hazardous farming and the consequent deforestation in the Amazon Region would not have occurred.

These cases have not been decided on the merits yet and it is still unclear whether courts will accept the banks' contention that they conducted appropriate due diligence before granting the loans and did not directly or indirectly approve any unlawful activity by borrowers.

Although these cases are still pending, they are generating great concern within the financial community. Banks started to fear that public prosecutors and courts may hold them liable for environmental damages caused by clients — regardless of fault — merely for having provided financing for activities that subsequently caused pollution.

This is because Brazilian Environmental Law requires the polluter, regardless of fault, to remediate or indemnify the damages caused to the environment. The concept of a "polluter" is broadly defined to include any entity that is directly or indirectly responsible for the activity causing environmental degradation. Accordingly, all parties directly or indirectly involved in an environmental damage are jointly and severally responsible for its remediation.

Should the mangrove case decision prevail, the notion of an "indirect polluter" could include not only banks, but also the environmental agency itself, as well as engineers, architects, real estate developers, brokers, etc., that may have facilitated third-party activities causing environmental harm.

The aftermath of the mangrove decision has motivated the Brazilian Central Bank to put out for public consultation a proposal for the adoption of new regulation for the definition of the obligations of financial institutions in connection with their operations in the country and with

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the evaluation of projects to be financed. These new rules may represent an important step towards the creation of minimum standards that are necessary to enable banks to implement environmental-risk management procedures targeted and try to avoid that the current uncertainty help fostering prosecutorial activism in this field.

The uncertainty that now reaches financial institutions in Brazil may impair responsible lending activity and cause disruption across the business environment until clear rules come to define what lenders can do to avoid environmental liability. The risk of unbounded liability for financial institutions can chill responsible funding of worthy projects, even when such funding is disbursed in compliance with applicable national, state and local law, as well as international standards.

This paper introduces the Brazilian Regime, presenting the main environmental legal milestones involving environmental civil liability applicable to lenders, as well as the related judicial decisions. Also, the present article contextualizes why environmental issues nowadays present a significant legal risk for lenders, especially to lending in support of infrastructure development on a project finance basis, and provides an overview of social and environmental voluntary initiatives related to lenders.

II. BRAZILIAN ENVIRONMENTAL LAW

The Brazilian environmental legal framework is composed by laws and rules promulgated in different moments of the last century. The management of this matter involves the establishment of guidelines, as well as administrative and operational activities, such as the planning, the guidance, the control and the allocation of environmental resources, all of them carried out with the scope of inducing positive effects on the environment.

The Federal Constitution of Brazil assigns to the Federal Government, the States, the Federal District and the Municipalities the responsibility for environmental protection and preservation of Brazilian fauna and flora. The authority to enact laws and issue regulations with respect to environmental protection is exercised concurrently by the federal government, the states and the municipalities. The Municipalities have authority to enact laws and issue regulations only with respect to matters of local interest or to supplement Federal and State laws.

In this context, Section 225 of the Brazilian Constitution classifies the environment as a common usage asset, essential to a good quality of life, and imposes on public authorities and on the community the duty to protect and defend it for present and future generations.

The Brazilian environmental policy counts with a specific federal law published on August 31, 1981, which provides for a National Environmental Policy, establishing its principles, objects, instruments and bodies.

This specific policy represents the major legal tool for the conduction of all the initiatives that have been and will be carried by the government and the organized civil entities. It is also an important instrument for the balance between the Brazilian society's aspirations and the environment, especially with regard to the economic aspects and to the control of the wastes management.

It is important to stress that not only the public sphere is responsible for the achievement of the Brazilian environmental policy, but also the society, as established in the Federal Constitution. Accordingly, while the State protects the public interests, the community will look after the general and particular interests.

III. ENVIRONMENTAL CIVIL LIABILITY

The Brazilian Civil Code (Federal Law No. 10.406/2002) consolidated important changes to the rules that regulate the civil liability. The new Civil Code shifted from the theory of liability

based solely on the concept of fault *lato sensu* - embracing the fault *strict sensu* (imprudence, negligence or misleading) and the intention of causing a damage (*dolus*) -, which brings the duty to repair solely in case of existence of fault, to the notion that liability also encompasses the duty to repair even without the existence of fault. Accordingly, the 2002 Code contemplated the subjective and the strict liability.

On one hand, Section 186[2] of the Civil Code states that whoever, by voluntary act or omission, negligence or imprudence, violates another's right and causes damage, even if moral damage, executes an illicit act[3]. Thus, under the subjective liability, the illicit act brings the obligation to remediate or repair the damage caused when there is evidence of fault. On the other hand, the sole paragraph of Section 927 sets forth that there is the obligation of repairing a damage caused independently of fault in cases specified by law and also in cases which the activity normally developed by the damage's author imposes, by its nature, risk to a third party right[4]. Accordingly, the Brazilian Civil Code currently also adopts the strict liability.

This double concept of civil liability is important for the interpretation and enforceability of the Environmental Law. Almost 20 years before the enactment of the current Civil Code, the National Environmental Policy already ruled on the strict liability for the remediation of environmental damages, based on the integral risk theory[5]. Amongst other reasons, the strict liability was considered the best remedy for the environmental remediation, recovery or indemnification due to the (i) collective nature of the environmental damage, which, by rule, reaches more than one victim; (ii) difficulty in providing evidence of the polluting party fault, most of the times titleholder of a valid environmental license or permit; and (iii) general rules of the civil law that encompass responsibility exemptions that did not fit into the full protection of the environment, such as the fortuitous acts and force majeure.

The National Environmental Policy, when regulating the environmental civil liability for damages caused to environment, sets forth that "the polluter is obliged, independently of fault, to indemnify or repair the damages caused to the environment and to third parties, affected by its activity"[6]. Moreover, "polluter" is defined as the natural or legal person, public or private, responsible, direct or indirectly, for the activity that caused the environmental degradation[7]. As a result of the strict liability, all the parties involved in an environmental damage shall be jointly and severally responsible for its recovery[8].

That being said, the contractual provisions existent among the involved parties will not refrain the Brazilian Public Prosecutor Officers from including all of them as defendants in a Civil Class Action (*Ação Civil Pública*). Furthermore, a single party may be held liable for redressing the whole environmental damage. In such case, the entity sued shall have a right of recourse

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[2] In Portuguese: "*Art. 186. Aquele que, por ação ou omissão voluntária, negligência ou imprudência, violar direito e causar dano a outrem, comete ato ilícito".*

[3] The definition of illicit act comes from the Brazilian Civil Code of 1916 (Federal Law No. 3.071/1916), which was revoked by the Brazilian Civil Code of 2002. Therefore, the illicit act comprehends a voluntary action or omission, negligence or imprudence, which violates a right or causes any damage to a third party and triggers the obligation of recovery.

[4] In Portuguese: "*Art. 927. Parágrafo Único. Haverá obrigação de reparar o dano, independentemente de culpa, nos casos especificados em lei, ou quando a atividade normalmente desenvolvida pelo autor do dano implicar, por sua natureza, risco para os direitos de outrem*".

[5] The integral risk theory is based on the premise that the polluter is accountable for all the activities to be taken for the prevention and repairing of environmental damages related to the activities performed by it, irrespective of fault.

6 In Portuguese: "*Art. 14, § 1º. Sem obstar a aplicação das penalidades previstas neste artigo, é o poluidor obrigado, independentemente da existência de culpa, a indenizar ou reparar os danos causados ao meio ambiente e a terceiros, afetados por sua atividade*".

7 In Portuguese: "Art. 3 *º, (iv).* "*poluidor, a pessoa física ou jurídica, de direito público ou privado, responsável, direta ou indiretamente, por atividade causadora de degradação ambiental*".

[8] Under the joint and several liability, a single party involved in an environmental damage may be responsible for the payment of the whole recovery, even if it is liable for just a parcel of the damage. The Brazilian Civil Code sets forth that, when the offense has more than one author, all of them will be considered joint liable for its recovery. In Portuguese: "*Art. 942. Os bens do responsável pela ofensa ou violação do direito de outrem ficam sujeitos à reparação do dano causado; e, se a ofensa tiver mais de um autor, todos responderão solidariamente pela reparação*".

against the one that caused the environmental impact of determined project, if and to the extent it can prove that the environmental damage or loss was attributable to such party.

In addition, demonstration of the cause-effect relationship between damage caused and action or inaction suffices to trigger the obligation to redress the environmental damage. Accordingly, proving the inexistence of the causality link between the environmental damage and the act (or omission) performed by a specific entrepreneur is the only chance for not being responsible for an environmental damage, considering that the mere inexistence of fault does not repel this responsibility.

Finally, the idea that the causality link is sufficient for triggering the strict liability has resulted on the shift of the burden of proof. In this sense, the Public Prosecutor's Office does not hold the burden of proving the existence of causality between the damage and the activity of the entrepreneur, since such encumbrance falls on the alleged polluter agent.

IV. PROJECT FINANCE AND ENVIRONMENTAL LIABILITY

A. Project Finance and Environmental Due Diligence

Project Finance is a method of financing where the lender accepts future revenues from a project as a guarantee on a loan. The credit granted by the financer is repaid primarily through cash flow and profits arising from the financed project[9].

The term Project Finance "is generally used to refer to a nonrecourse or limited recourse financing structure in which debt, equity, and credit enhancement are combined for the construction and operation, or the refinancing, of a particular facility in a capital-intensive industry, in which lenders base credit appraisals on the projected revenues from the operation of the facility, rather than the general assets or the credit of the sponsor of the facility, and rely on the assets of the facility, including any revenue-producing contracts and other cash flow generated by the facility, as collateral for the debt"[10].

The repayment of debt is not based on the assets reflected on the sponsoring company's balance sheet, but on the revenues that the project will generate once it is completed, held by the Special Purpose Vehicle ("SPV")[11] borrower of the proceeds.

Considering that the project is the debtor of the bank and that the bank is repaid only from project cash flow, lenders shall take a closer look at such projects in order to determine whether their interests will be adequately protected by means of the implementation of the project. Any disruption in project construction or operations would, of course, threaten the borrower's ability to repay, being that a central focus in the credit risk analysis.

It is well known that environmental concerns can disrupt project construction and operations. Because of such risk, financial institutions typically evaluate a project's environmental profile in considerable detail before making a commitment to the project and before any disbursement of credit.

Generally, the environmental due diligence encompasses an evaluation of the area where the project will be constructed, including: (i) history of the use and occupation of the site and nature and condition of the project; (ii) potential liability for cleanup of pre-existing contamination at the site; (iii) (degraded areas or areas that should be preserved; (iv) debt clearance certificates, in order to attest whether there are any judicial and/or administrative

[9] Today, various sectors employ project finance, including power, transportation, oil and gas, petrochemicals, mining, industry, waste and recycling, and agriculture.
[10] Scott L. Hoffman, *A Practical Guide to Transactional Project Finance: Concepts, Risk Identification, and Contractual Considerations*, 45 Bus. Law. 181 n. 1 (1989) *in* Scott L. Hoffman, *The Law and Business of International Project Finance*, p. 4.
[11] The SPV is the legal entity that contracts with other parties involved in the development process.

proceedings relating to environmental matters; (v) the policies for disposal of residues of the project, and the nature and condition of off-site disposal locations to be used; (vi) licenses, permits, authorizations and technical reports already issued for the site[12]; and (vii) the legal department environmental files of the area and the files of the outside law firms that have handled environmental matters for the company.

Once all this data is obtained, depending on the circumstances, additional publicly available data from the state and federal environmental agencies may be requested. Such due diligence is typically executed by a competent multidisciplinary team (lawyers and technical consultants) and identifies the possible existing environmental contingencies and liabilities, as well as the feasibility of the project from an environmental perspective.

In this sense, independently of the limits of the environmental liability for lenders, environmental due diligence is an indispensable instrument to avoid credit risk, especially in project finance transactions. A lending strategy that addresses the risk of environmental liability should encompass the full range of lender activities, from evaluating loan prospects, extending funds, and policing loans and workouts to conducting foreclosure and post foreclosure activities[13].

Lenders in Brazil are uncertain as to whether such detailed oversight of their borrower's environmental compliance matters would result in them being considered to be participating in the management of the project and, consequently, increasing the risk of being considered to be jointly liable in the event of environmental damage.

The lack of definition in Brazil as to what is and is not allowed for banks constitutes a barrier for them to take steps to require their borrowers' operations to be conducted in a safer manner to protect the environment.

1. Drafting Contractual Language in Project Financing

Having concluded the site assessment and complied with the socio-environmental voluntary initiatives described below, banks need to assess whether domestic approvals meet legal requirements and whether appropriate risk assessment strategies are employed. This measure will help banks to identify, in advance, potential issues in relation to the project and, therefore, the default of obligations in the payments of amounts due under the financing granted.

After that, the transaction is structured and the financing documents are drafted and the financial institution requires the borrower to give certain representations and warranties about, amongst others, the environmental aspects of the project, and create obligations to be observed during the entire implementation and construction of the project.

Representations and warranties form the basis of most business transactions, including a project financing. A representation is a statement by a contracting party to another contracting party about a particular fact that is correct on the date when made[14]. A warranty is a duty created in a contract, a guarantee that a given fact will exist as warranted at some

[12] The risk that a project does not have, or might not obtain, permits necessary for the location, construction or operation of the project, which includes the environmental permits, is a significant concern to all project participants. In Brazil, the level of due diligence of a financial institution in order for avoiding being liable for the remediation of an environmental damage is still unclear, which brings a high level of uncertainty whether courts will consider banks as indirect polluters of a determined project.

[13] WITKIN, James B. Environmental Aspects of Real Estate Transactions: from Brownfields to Green Buildings. When talking about practical solutions to lender's concerns, the author addresses that due diligence can produce a range of valuable information. On the basis of its preliminary environmental due diligence activities, the lender may be satisfied that the environmental risks, if any, are manageable and decide to lend or require a borrower to perform certain activities either before a loan is made or once the loan is made.

[14] A representation is made about either a past or present fact but never a future fact.

future date. The untruth of any representation and warranty is an event of default under the contract.

In a concise manner, the most relevant representations and warranties are the ones that provides for the conformity with environmental legislation, with the social and environmental parameters from the International Finance Corporation ("IFC"), the Social and Environmental Management Plan, as well as the regular existence/maintenance of all environmental licenses and authorizations necessary for the current status of the project, the absence of environmental liabilities (including contamination of underground water and the soil), and the absence of administrative processes (infractions and notices), judicial lawsuits (especially civil class actions) and preparatory procedures (civil and police investigations).

The first standard representation and warranty states that the borrower has obtained all permits, licenses, and other authorizations required by any federal, state, local or other law relating to pollution or protection of the environment necessary for the current status of the project, or otherwise relating to the manufacture, processing, distribution, use, treatment, storage, disposal, transport, or handling of pollutants, contaminants, chemicals, or industrial, toxic or hazardous substances or wastes (in other words, the "environmental laws").

The second standard representation and warranty states that the borrower is in compliance with (i) all terms and conditions of such permits, licenses and authorizations; (ii) all applicable provisions of the environmental laws; and (iii) the provisions of all applicable administrative and judicial orders and judgments to which it is subject.

The third standard representation and warranty states there is no environmental litigation administrative or judicial proceeding or order, consent decree, or investigation pending or threatened against the borrower.

Finally, the fourth standard representation and warranty states that the borrower knows of no events or conditions that may prevent the continued compliance with all applicable permits, environmental laws and orders applicable to the project.

In addition to these representation and warranties, loan agreements also typically include affirmative covenants to ensure environmental compliance through the life of the project, and provide lenders with the power to require their borrowers to cure environmental violations should they arise, even if such violations are not the subject of governmental enforcement actions.

B. Socio-environmental voluntary initiatives related to lenders

Socio-environmental voluntary initiatives are a way to determine, calculate and manage the social and environmental risks associated with certain projects that seek financing.

In this sense, the voluntary initiatives serve as the common standards and requirements for the implementation, by each financial institution, of its internal policies related to the social and environmental area and of its procedures and rules related to project finance activities.

1. Performance Standards of World Bank and IFC

The Performance Standards of the IFC, financial arm of the World Bank, which are also observed on a voluntary basis by signatories of the Equator Principles, are evidence of the importance of managing environmental and social performance throughout the life of a project, and also guarantee the (i) identification and evaluation of environmental and social risks and impacts of a project; and, (ii) adoption of a mitigation plan to compensate the risks and impacts to workers, affected communities and the environment.

In addition to meeting the requirements under the Performance Standards, clients must comply with applicable national law, including those laws implementing host country obligations under international law.

The World Bank Group Environmental, Health and Safety Guidelines ("EHS Guidelines")[15] are technical reference documents with general and industry-specific examples of good international industry practice.

IFC uses the EHS Guidelines as a technical source of information during project appraisal. The EHS Guidelines contain the performance levels and measures that are normally acceptable to IFC, and that are generally considered to be achievable in new facilities at reasonable costs by existing technology. For IFC-financed projects, application of the EHS Guidelines to existing facilities may involve the establishment of site-specific targets with an appropriate timetable for achieving them. The environmental assessment process may recommend alternative (higher or lower) levels or measures, which, if acceptable to IFC, become project or site-specific requirements.

The General EHS Guideline contains information on crosscutting environmental, health, and safety issues potentially applicable to all industry sectors. It should be used together with the relevant industry sector guidelines.

The IFC Performance Standards ("PSs") were updated and re-launched in January 2012. Together, the eight PSs establish standards that the client is to meet throughout the life of an investment by IFC, as follows: (i) PS 1 – Assessment and Management of Environmental and Social Risks and Impacts; (ii) PS 2 – Labor and Working Conditions; (iii) PS 3 – Resource Efficiency and Pollution Prevention; (iv) PS 4 – Community Health, Safety, and Security; (v) PS 5 – Land Acquisition and Involuntary Resettlement; (vi) PS 6 – Biodiversity Conservation and Sustainable Management of Living Natural Resources; (vii) PS 7 – Indigenous People; and, (viii) PS 8 – Cultural Heritage. For the purposes of this work, it is worthy briefly summarizing part of them.

The Performance Standard 1 applies to all projects that have environmental and social risks and impacts and guarantees the conduction of an environmental and social assessment, to establish an Environmental and Social Management System ("ESMS") suitable to the nature and scale of the project and in accordance with its environmental and social risks and impacts. Such ESMS shall incorporate the following elements: (i) policy; (ii) identification of risks and impacts; (iii) management programs; (iv) organizational capacity and competency; (v) emergency preparedness and response; (vi) stakeholder engagement; and, (vii) monitoring and review.

In its turn, the Performance Standard 3 recognizes that increased economic activity and urbanization generate increased levels of pollution to air, water and land and consume finite resources in a manner that may threaten people and the environment at the local, regional and global levels. Therefore, the Performance Standard 3 guarantees the development of a project to approach resource efficiency and pollution prevention and control in line with internationally disseminated technologies and practices.

In addition, Performance Standard 6 recognizes that protecting and conserving biodiversity, maintaining ecosystem services, and sustainably managing living natural resources are fundamental for the sustainable development. Thus, the projects (i) located in modified, natural and critical habitats; (ii) that potentially impact on or are dependent on ecosystem services over which the client has direct management control or significant influence; or (iii)

[15] The EHS Guidelines were developed as part of a two and a half year review process that ended in 2007. For the updated version of the EHS Guidelines, please access the following website: http://www1.ifc.org/wps/wcm/connect/Topics_Ext_Content/IFC_External_Corporate_Site/IFC+Sustainability/Sustainability+Framework/Environmental,+Health,+and+Safety+Guidelines/.

that include the production of living natural resources shall follow such Performance Standard.

Finally, the Performance Standards 7 and 8 set forth the necessity of protection of indigenous people and of cultural heritage. Therefore, the potential client shall identify, through an environmental and social risk and impact assessment, all the eventual communities of indigenous people within the project area of influence, as well as any chance of impact to cultural heritage, which shall not be subject to any interference.

2. Equator Principles

The most relevant initiative related to financial institutions that must be taken into consideration in the international arena is the Equator Principles. The Equator Principles were launched in June 2003 and revised in 2006 and have been based on the IFC Performance Standards and on the World Bank Group EHS Guidelines[16].

A new version[17] is expected to be published in 2013[18], since another round of revision has already been initiated with the involved stakeholders. The Equator Principles Association, an unincorporated association of member EPFIs and Associates, is committed to reviewing the EP framework from time-to-time to reflect ongoing learning and emerging good practice.

Currently, the Equator Principles is a risk framework for identifying, assessing, and managing environmental and social risks in Project Finance transactions[19] and set up the minimum socio-environmental criteria for the granting of credits higher than US$ 10 million by the adopting financial institutions, with the purpose to assure adequate practices of social and environmental management of the projects financed.

An Equator Principles Financial Institution ("EPFI") is a financial institution that adopts the Equator Principle and is active in Project Finance or Project Finance Advisory services. EPFIs commit to not providing loans to projects where the borrower will not, or is unable, to comply with their respective social and environmental policies and procedures.

According to the Equator Principles, there is a categorization of the financed projects pursuant to their risk, being A projects with potential significant adverse environmental and social risks, B projects with potential limited adverse environmental and social risks and/or impacts and C projects of low risk and/or impacts.

Category A and some Category B projects (in this case, upon the discretion of the financial institutions) shall observe specific obligations to be complied with by the respective borrower,

[16] Banco Bradesco, Banco do Brasil, Santander, Itaú Unibanco and Caixa Econômica Federal are among the Brazilian financial institutions that have adhered to the Equator Principles. As per the Equator Principles website (www.equator-principles.com), 77 financial institutions in 29 countries have officially adopted the Equator Principles, covering over 70 percent of international project finance debt in emerging markets.

[17] The Equator Principles Association released the draft of the updated Equator Principles ("EP III") on August 13, 2012 for stakeholder consultation and public comment. In summary, the key themes and areas of development proposed in the EP III draft include: (i) an extension in the scope of the Equator Principles to Project-Related Corporate Loans and Bridge Loans; (ii) changes reflecting the new version of the IFC Performance Standards; (iii) new requirements related to managing impacts on climate; (iv) greater emphasis on human rights considerations in due diligence and an acknowledgment of the UN "Protect, Respect and Remedy" Framework for Business and Human Rights and Guiding Principles on Business and Human Rights; and (v) a strengthening of reporting and transparency requirements.

[18] January 2013 is an unofficial date provided by the Equator Principles Association on September 14, 2012 at the Multi-Stakeholder Meeting held in Sao Paulo, Brazil.

[19] The Equator Principles framework was originally created for environmental and social risk management in Project Finance transactions. While the proposal of the EP III is to extend the scope of the Equator Principles to Project-Related Corporate Loans and Bridge Loans, the focus will still be on Project Finance and Project Finance Advisory services as it easily follows a project's financing, development and operational cycle. Bridge Loan is an interim loan given to a business until the longer-term stage of financing can be obtained. Project-Related Corporate Loans are corporate loans, made to business entities (either privately, publicly, or state-owned or controlled) related to a single Project, either a new development, expansion (e.g. where there is an expanded footprint) or upgrade.

embracing: (i) carrying out a Social and Environmental Assessment[20]; (ii) building on an Action Plan[21] and a Management System[22]; (iii) establishing consultation and disclosure procedures related to affected communities in a structured and culturally appropriate manner; and (v) providing covenant to a) comply with all relevant host country environmental and social laws, regulations and permits in all material respects; b) comply with the Action Plan during the construction and operation of the project in all material respects; c) submit periodic reports prepared by in-house staff or third party experts, which document compliance with the Action Plan and provide representation of compliance with relevant local, state and host country social and environmental laws, regulations and permits; and d) decommission the facilities.

3. Green Protocol

In the domestic sphere, the Green Protocol (*Protocolo Verde*) is the most important initiative of public and private financial institutions which, together with the Environment Ministry, in 1995 and 2009 respectively, signed a letter of intent for environmental and social responsibility.

Anchored in the National Environmental Policy, object of Section 1 of this Chapter, the Green Protocol's objective is to engage financial institutions in the adoption of banking practices and policies that (i) are precursors and multipliers of socio-environmental sustainability; and (ii) promote development that does not compromise the needs and rights of future generations. The National Development Bank (*Banco Nacional de Desenvolvimento Econômico e Social*, or "BNDES"), Caixa Econômica Federal, Banco da Amazônia S.A., Banco do Nordeste do Brasil and the Brazilian Federation of Banks (*Federação Brasileira de Bancos*, or "FEBRABAN"), the Protocol's participants, are committed to using socio-environmental practices in their business transactions that encompass: (i) offering credit lines that promote quality of life and encourage sustainable use of the environment; (ii) taking into account socio-environmental impacts in asset management and costs in their risk analyses and in investment projects; (iii) promoting sustainable consumption of natural resources, and materials derived from such natural resources, at the internal processes; (iv) informing, raising awareness and continuously engaging stakeholders in sustainable policies and practices of the institution; and, (v) promoting harmonization of procedures, cooperation and integration of efforts among the organizations and the guidelines established by the referred Protocol.

Although the Green Protocol did not establish legally binding rights or responsibilities to its signatories, the document, as the Equator Principles, requires that the financial institutions periodically publish the results of the implementation of their guidelines. As such, the disclosure of information regarding its implementation is a key measure to bring transparency to the actions taken by financial institutions, improve the social and environmental practices adopted and promote the ongoing engagement and awareness of the civil society, government and businesses.

V. OVERVIEW OF BRAZIL'S ALARMING ENVIRONMENTAL SCENARIO FOR LENDERS

As already highlighted in the present article, the National Environmental Policy sets forth that the polluter is obliged, independently of fault, to indemnify or repair the damages caused to the environment and to third parties affected by its activity. Moreover, "polluter" is defined as

[20] Social and Environmental Assessment ("Assessment") is a process that determines the environmental and social risks and impacts (including labor, health, and safety) of a proposed Project in its area of influence.

[21] Action Plan is prepared, as a result of the EPFI due diligence, to describe and prioritize the actions needed to address any gaps in the Assessment to bring the project in line with applicable standards as defined in the Equator Principles. The Action Plan is typically tabular in form and lists distinct actions from mitigation measures to follow-up studies or plans that complement the Assessment.

[22] Management System is the overarching environmental, social, health and safety management system, which may be applicable at a corporate or project level. The system is designed to identify, assess and manage risk in respect to the project on an ongoing basis.

the natural or legal person, public or private, responsible, direct or indirectly, for the activity that caused the environmental degradation.

Accordingly, as a result of the strict liability, all the parties involved in an environmental damage shall be jointly and severally responsible for its recovery. The doubt that is frequently raised due to this ample definition of "indirect polluter" is whether financial institutions may be considered as an indirect polluter if a given project financed by such institutions causes an environmental damage.

Although the doctrine and jurisprudence are vast with respect to indirect polluters, there is still no deep analysis related to the definition of the indirect contribution for the activity that caused the environmental degradation. In other words, even though there is no questioning about the indispensable conditions for the responsibility on the environmental civil sphere (i.e. author - direct or indirect polluter -, occurrence of an environmental damage and causality relation), there is no definition of the limits of the indirect contribution for the activity that caused the environmental degradation.

One could understand the contribution that confers a causality relation and, thus, the environmental civil liability, as the one related to the activity that caused the environmental damage and not those related to the economic activity of a determined company or institution.

Therefore, on one hand, a financial institution would only be considered joint liable under the environmental sphere when the granting of finance (by means of a project finance, for instance) to a specific client if not considered enough diligent under an environmental and social perspective and results in a determined activity that causes indeed damage to the environment. On the other hand, the mere conduction of the financial institution economic activity, which is part of its daily routine, could not give rise for lenders being held liable for an eventual environmental damage caused by one of its clients.

Unfortunately, Brazilian discussions on the level of socio-environmental diligence that a financial institution shall apply to hinder the environmental liability are very insipient, being restricted to some representatives of the sector, environmental lawyers and scholars.

What can be affirmed in the field of the environmental liability of the financial institutions is that the National Environmental Policy, by means of its Section 12, establishes that governmental financial institutions must condition their disbursement of funds to the compliance with the environmental licensing process and the rules and standards set forth by CONAMA. In addition, the sole paragraph of the mentioned Section determines that the public lenders must require the development of civil works and the acquisition of equipment destined to the control of environmental degradation and to the improvement of the environmental quality in the financed projects[23].

It is important to observe that the National Environmental Policy is silent in relation to the private lenders and there is no precedent that could be singled out where a private lender has been considered liable for any environmental damage caused by one of its clients and has faced clean up costs.

However, in December 2009, the Superior Court of Justice, Brazil's highest federal court of appeals on non-constitutional matters, issued a decision involving damage to a mangrove area allegedly caused by a hardware manufacturer that attracted much attention by lenders. The decision stated that, "for the purpose of evidencing the chain of causation in

[23] In Portuguese: "*Art. 12. As entidades e órgãos de financiamento e incentivos governamentais condicionarão a aprovação de projetos habilitados a esses benefícios ao licenciamento, na forma desta Lei, e ao cumprimento das normas, dos critérios e dos padrões expedidos pelo CONAMA. Parágrafo único - As entidades e órgãos referidos no "caput" deste artigo deverão fazer constar dos projetos a realização de obras e aquisição de equipamentos destinados ao controle de degradação ambiental e à melhoria da qualidade do meio ambiente*."

environmental damage, equivalent liability attaches to those who do, those who don't do when they were supposed to, those who fail to do, those who don't care about others doing, *those who finance what others do,* and those who benefit when others do." This statement, and in particular its reference to "those who finance what others do," has created significant concern that banks could find themselves enmeshed in a web of environmental liability based on the action or inaction of their borrowers.

A well-known opinion by one of the judges who ruled in the mangrove case reinforced the notion that an "indirect polluter" could include not only banks, but also the environmental agency, engineer, architect, real estate developer, and broker that are deemed to be facilitating or enabling the environmental harm.

In this sense, although there is no express provision in the Brazilian legislation specifically addressed to private lenders and the domestic case law on environmental liability of private financial institutions is still not consolidated, some representatives of the Public Prosecutor's Office consider that the mere fact of funding a project that caused an environmental damage could be sufficient to characterize a cause-effect relationship.

As consequence of these interpretations, two class action lawsuits were filed in 2011 by the Federal Prosecutor against Banco da Amazônia S.A. ("BASA") and Banco do Brasil ("BB"). The main allegation against the banks in those cases is that they failed to comply with Brazilian environmental legislation when they granted credit for cattle raising on lands located in the Amazon Region. The Federal Prosecutor generally asserted that, without that credit, the allegedly unlawful cattle raising, and the consequent deforestation in the Amazon Region, would not have occurred.

These cases have not been decided on the merits. Nonetheless, their mere filing has turned into one of the top environmental concerns in Brazil. It is not yet clear whether the court will accept the banks' contention that they exercised due diligence in granting the credits and that they did not directly or indirectly approve of any unlawful activity by their borrowers.

Meanwhile, a recent initiative from Banco Central do Brasil ("BCB") moved banks to discuss and contribute for the definition of the socio-environmental criteria of the evaluation of projects and operations of financial institutions in the country. BC proposed two rules relating to the socio-environmental liability police of financial institutions, which was subject to public comments and is waiting for publication.

Amongst the content of these rules, BCB expressed that the management of the socio-environmental risk of financial institutions shall consider the evaluation of the operations based on consistent criteria, such as: (i) economic sector and location of the client activity and operation; (ii) documental analysis of the operation and of the client, in relation to eventual restrictions and the compliance with the legal requirements relating to socio-environmental matters; (iii) use of instruments that proportion effective mitigation of socio-environmental risks; (iv) quality of guarantees of the operation in relation to socio-environmental aspects; (v) quality of socio-environmental management of the client; and (vi) public information. It is worth mentioning, however, that the rules do not express what activities banks can do without being considered liable in the environmental sphere, e.g., no limitation of liability for lenders was addressed in these proposals.

The BCB rulings may configure an important step for the construction of a minimum standard of environmental management and criteria for the financial services and products. It is worth mentioning, however, that the rules do not express what activities banks can do without being considered liable in the environmental sphere, e.g., no limitation of liability for lenders was addressed in these proposals. It is our hope that the rule will explicitly state that adherence to such rules will satisfy a bank's burden of proof to establish that it is not indirectly responsible for its borrower's pollution.

VI. FINAL CONSIDERATIONS

Having presented the main environmental milestones involving environmental civil liability applicable to lenders, it is worth highlighting that:

(i) The National Environmental Policy, when regulating the environmental civil liability for damages caused to environment, sets forth that "the polluter is obliged, independently of fault, to indemnify or repair the damages caused to the environment and to third parties, affected by its activity". Moreover, "polluter" is defined as the natural or legal person, public or private, responsible, direct or indirectly, for the activity that caused the environmental degradation. As a result of the strict liability, all the parties involved in an environmental damage shall be jointly and severally responsible for its recovery;

(ii) Independently of the limits of the environmental liability for lenders, environmental due diligence is an indispensable instrument to avoid credit risk, especially in project finance transactions. A lending strategy that addresses the risk of environmental liability should encompass the full range of lender activities, from evaluating loan prospects, extending funds, and policing loans and workouts to conducting foreclosure and post foreclosure activities;

(iii) Lenders in Brazil are uncertain as to whether such detailed oversight of their borrower's environmental compliance matters would result in them being considered to be participating in the management of the project and, consequently, increasing the risk of being considered to be jointly liable in the event of environmental damage;

(iv) The lack of definition in Brazil as to what is and is not permitted for banks constitutes a barrier for banks to take steps to require their borrowers' operations to be conducted in a safer manner to protect the environment; and

(v) Recent court cases in Brazil are creating significant concern within the financial community that public prosecutors and courts may impose liability on banks — without regard to fault — merely because they provided financing for activities that later caused pollution. As a result, and especially until the applicable rules are well developed, lenders should carefully evaluate the environmental aspects of projects in Brazil and understand the current status of the liability regime before disbursement of any loan.

The uncertainty that now bedevils financial institutions in Brazil may chill responsible lending activity and cause unwarranted disruption until the law is clarified to better define what lenders can do to ensure that they do not attract environmental liability.