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## Brazil's Launch of Lender Environmental Liability as a Tool to Manage Environmental Impacts

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# BRAZIL'S LAUNCH OF LENDER ENVIRONMENTAL LIABILITY AS A TOOL TO MANAGE ENVIRONMENTAL IMPACTS

Bianca Zambão\*

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**ABSTRACT:** Due to an emerging Brazilian doctrine of environmental liability, lenders now face the prospect of lawsuits that seek remediation of, or compensation for, environmental damages resulting from their borrowers' activities. Unprecedented judicial decisions (based on a strict, joint and several environmental liability for lenders) broad standing, and on-going initiatives of the government portray financial institutions as the best target to pursue environmental protection in the country. That scenario, however, may represent a detour from the imperative improving the functionality of the public administration. This article examines how legal actors are shaping Brazil's environmental law enforcement and the extent to which it affects financial institutions, and also the grounds where the lender environmental liability scheme applied in the United States was tailored to sound banking

practices. This article concludes that placing lenders as substitutes for the public administration should not be misunderstood as consistent with a modern business model based on accountability, and will impose political and economic costs on the sustainable development of the country. This article also suggests practices that might be employed to enhance deals in Brazil, but in a safer manner for lenders.

## I. INTRODUCTION

Brazil's highest court for all federal matters except constitutional appeals recently declared that lenders aware of environmental damages created by their borrowers should bear strict, joint and several liability for such damage. Brazil's National Environmental Policy law provides the basis for this liability, requiring only causation and injury to be established before a court in order to constitute a tort claim sufficient to impose liability upon a direct or even an indirect polluter. Lenders are commonly identified as within the category of indirect polluters. Moreover, Brazil's Federal Constitution explicitly requires balancing economic growth and environmental protection, which not only drives both government and society towards sustainable development, but arguably also supports the court's view of lender environmental liability.

Lenders now face the prospect of lawsuits by both the Public Ministry and non-governmental organizations (NGOs) that seek remediation of, or compensation for, environmental damages resulting from their borrowers' activities.<sup>1</sup>

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The emerging Brazilian doctrine of environmental lender liability does not on its face fully reveal the dynamic behind it. Brazil's Ministry of the Environment appears to endorse the belief that regulating the terms of financing is a replacement for the instruments of environmental command-and-control policies. If not properly managed, this belief risks to establish lender liability as a weak substitute for a system of environmental impact assessment and environmental permitting conducted by the public administration.

The approach in the United States to environmental lender liability commenced in a similarly scary way for lenders, but matured into a measured tool to incentivize proper lender behavior. The foundation and development of this extended liability for lenders in the United States sheds important light on transactions and enforcement actions that are to come in Brazil, especially for financial institutions that have aggressive internal policies of environmental assessment and due diligence investigation.

The "best practices" lending procedures of export credit agencies (ECAs) and multilateral development banks (MDBs), whose procedures have been extended to commercial banks through their widespread adoption of the Equator Principles, exacerbate the likelihood of such a lender's liability under Brazilian law. This is a perverse result because these lending practices, if fully and diligently applied, are highly effective instruments to support lenders' risk management and to mitigate the likelihood of environmental damaging activities.

Section II presents unprecedented judicial decisions and ongoing initiatives of key actors in Brazil that illustrate the reason why environmental issues present a significant legal risk to lending in Brazil, particularly to lending in support of infrastructure development on a project financing basis. This study also analyzes

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<sup>1</sup> "Public Ministry" is a literal translation of "Ministério Público," Brazil's independent enforcement body comprised of its prosecutors.

Brazil's legal and regulatory framework to demonstrate that environmental exposure for lenders involves risks beyond those conventionally considered in legal risk management. Section III explores lessons to be drawn from the definition and use of "owner and operator" liability, which has been a crucial factor in the development of lender environmental liability in the United States, and compares the state of the law in the United States and Brazil. Section IV reviews the environmental diligence practices of the MDBs and ECAs, as well as of the Equator Principles. It explores how these practices can aggravate lender liability under the emerging law in Brazil, and also how they might be employed to enhance deals in Brazil, but in a safer way for lenders.

## II. BRAZIL'S ALARMING ENVIRONMENTAL SCENARIO FOR LENDERS

Unprecedented judicial decisions and ongoing initiatives of key actors in Brazil raise the prospect that lenders may also be liable for environmental damages created by their borrowers. As a result, environmental risks faced by lenders include not only those that would impede repayment of the debt or damage the lender's reputation. Especially in view of the number and size of infrastructure projects anticipated in Brazil in the next few years,<sup>2</sup> these developments in Brazil's environmental law merit the attention of lenders.

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<sup>2</sup> See John Rumsey, *Do Brazil's Infrastructure Plans Have a Sporting Chance?*, PROJECT FIN. MAG., Dec. 16, 2009, at Features. In addition to the 2014 World Cup and the 2016 Rio Olympics, the excitement about infrastructure opportunities in Brazil is becoming widespread. The country now enjoys a "large market, good assets, and stable economy." The scenario looks promising. "In five years, Brazilian infrastructure investments will be running at \$92 billion per year, compared to \$61 billion in 2008 and just \$30 billion in 2003."). *Id.*

### *A. Recent Judicial Decisions and the Brazilian Environmental Law*

In 2009, the Superior Court of Justice, Brazil's highest federal court of appeals on non-constitutional matters,<sup>3</sup> issued alarming decisions in lawsuits related to environmental damage. These decisions imply that lenders can be considered indirect polluters under a strict, joint and several liability scheme, even before foreclosure.

A decision published in December 2009,<sup>4</sup> involving the Federal Public Ministry and a hardware manufacturer regarding environmental damages in a mangrove area, would not have deserved much attention by lenders had not the Superior Court of Justice<sup>5</sup> also broadly analyzed what additional entities could be liable for the environmental damages, without regard to culpability. Even though no financial institution has been part of a suit involving a sensitive coastal ecosystem, this higher court, through a unanimous decision, sent an alarming message, stating that:

For the purpose of determination of the proximate cause in environmental damage cases, one who commits [the act] shall be *equated* with one who does nothing when he or she should act, who allows it to happen, who does not care what is being done, *who is financing* so that it can be done, and who benefits when others act.<sup>6</sup>

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<sup>3</sup> CONSTITUIÇÃO FEDERAL [C.F.] [CONSTITUTION] Oct. 15, 1988, art. 105 (Braz.).

<sup>4</sup> S.T.J.-T2, REsp 650728, Relator: Min. Benjamin Herman, 23.10.2007, REVISTA DO SUPERIOR TRIBUNAL DE JUSTIÇA [R.S.T.J.], 02.12.2009 (Braz.)

<sup>5</sup> The Superior Court of Justice is composed of three sections; specialized respectively in (i) public, (ii) private, and (iii) criminal and social security laws. *Turmas de Julgamento*, SUPERIOR TRIBUNAL DE JUSTIÇA, [http://www.stj.gov.br/portal\\_stj/publicacao/engine.wsp?tmp.area=432](http://www.stj.gov.br/portal_stj/publicacao/engine.wsp?tmp.area=432) (last visited Jan. 25, 2011). This case was judged by the Second Group of the First Section.

<sup>6</sup> S.T.J.-T2, REsp 650728, Relator: Min. Benjamin Herman, 23.10.2007, R.S.T.J., 02.12.2009 (Braz.) (emphasis added) (original wording: "Para o fim de apuração do nexo de causalidade no dano ambiental, equiparam-se quem faz, quem não faz quando deveria fazer, quem deixa fazer, quem não se importa que façam, quem financia para que façam, e quem se beneficia quando outros fazem."). All Brazilian cases cited in this article can be retrieved by case number at <http://www.stj.jus.br>.

Another 2009 pronouncement of the same Court speaks more directly to lenders' liability for environmental damages created by their borrowers. In this case, the Federal Public Ministry sued the Brazilian Development Bank (BNDES), among others, for environmental damages as consequence of a borrower's mining activities. The Superior Court of Justice, in a decision made by a single Justice,<sup>7</sup> implied that banks can limit liability by establishing diligent inquiry, but confirmed liability where banks disbursed funds with knowledge of the environmental concern. The Court stated:

Regarding BNDES, the simple fact that it is the financial institution responsible for financing the mining activities . . . at a first analysis, does not establish that it can be a defendant in the case. However, if there is evidence that this government-owned corporation [BNDES] was even aware of serious and severe environmental harm [and] . . . has released intermediate or final disbursements to the mining project . . . in this case, [BNDES] shall be under a joint and several liability for damages.<sup>8</sup>

The scope of this liability is found in the National Environmental Policy Act,<sup>9</sup> where article 14, paragraph 1 states:

[T]he polluter is required, *regardless of fault*, to *compensate or repair* damage caused to the environment or to third

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<sup>7</sup> The opinion of the court occurred under a monocratic decision—decision taken by a single judge – because the appellant did not satisfy all the requirements to have the case analyzed by a panel.

<sup>8</sup> S.T.J., REsp 995321, Realtor: Min. Benedito Gonçalves, 15.10.2007, R.S.T.J., 15.12.2009 (Braz.) (original wording: “Quanto ao BNDES, o simples fato de ser ele a instituição financeira incumbida de financiar a atividade mineradora . . . em princípio, por si só, não o legitima para figurar no pólo passivo da demanda. Todavia, se vier a ficar comprovado . . . que a referida empresa pública, mesmo ciente da ocorrência dos danos ambientais que se mostram sérios e graves . . . houver liberado parcelas intermediárias ou finais dos recursos para o projeto de exploração mineral . . . , aí, sim, caber-lhe-á responder solidariamente com as demais entidades-rés pelos danos . . .”).

<sup>9</sup> Lei No. 6938, de 31 Agosto de 1981, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 02.09.1981 (Braz.).

parties as a result of the polluter's activities. The Federal and State prosecutors have standing to initiate civil or criminal action to determine liability for environmental damage against polluters.<sup>10</sup>

The National Environmental Policy Act in fact imposes strict liability on behalf of the polluter by paying for the environmental harm or paying compensatory damages. Its imposition of liability satisfies conventional definitions of strict liability, namely, liability that "does not depend on actual negligence or intent to harm, but that is based on the breach of an absolute duty to make something safe."<sup>11</sup> Moreover, suing a polluter under the Brazilian tort system requires no demonstration of recklessness or malpractice. The only elements required to be established are causation and injury.

According to another 2009 case by the Superior Court of Justice, in which the Public Ministry of the State of Goiás brought suit against a major electric utility company, among others, for environmental damages as a result of the construction of a hydropower plant, "[l]iability for environmental damage is under a strict liability scheme and, as such, does not require proof of culpability, but only the finding of a nexus between injury and causation."<sup>12</sup> This decision was unanimous.

For the purposes of Brazilian law, a polluter is "the person or entity, whether government-owned or not, *directly or indirectly responsible* for the activity that causes environmental degradation."<sup>13</sup>

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<sup>10</sup> *Id.* (emphasis added) (original wording: "[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. O Ministério Público da União e dos Estados terá [sic] legitimidade para propor ação de responsabilidade civil e criminal, por danos causados ao meio ambiente.").

<sup>11</sup> BLACK'S LAW DICTIONARY, 998 (9th ed. 2004).

<sup>12</sup> S.T.J., REsp 1056540, Realtor: Min. Eliana Calmon, 16.05.2008, R.S.T.J., 14.09.2009 (Braz.) (emphasis added) (original wording: "[a] responsabilidade por danos ambientais é objetiva e, como tal, não exige a comprovação de culpa, bastando a constatação do dano e do nexo de causalidade.").

<sup>13</sup> Lei No. 6.938, 31 de Agosto de 1981, D.O.U. 02.09.1981 (Braz.) (emphasis added) (original wording: "[E]ntende-se por . . . poluidor, a pessoa física ou jurídica,



Therefore, the Brazilian federal environmental statute imposes not only a strict liability scheme, but also a joint and several liability regime, meaning that “[l]iability . . . may be apportioned either among two or more parties or to only one or a few select members of a group, at the adversary’s discretion.”<sup>14</sup>

Hence, there are two substantial features to be considered. First, the “imposition of this liability . . . need not to be ‘fingerprinted’ or linked directly back to a particular party to be responsible for [damages].”<sup>15</sup> Second, the party who brings a civil suit has the freedom (or power) to decide which of the direct and indirect polluters to pursue for damages. Defendants, however, maintain the right to sue responsible parties for contribution (if both are direct polluters) or for recovery (if the defendant is an indirect polluter). As confirmed by the Superior Court of Justice in the case mentioned above: “[t]he joint and several liability arises from the National Environmental Policy Act, article 3(IV) and article 14, paragraph 1.”<sup>16</sup>

The higher courts of Brazil’s states (*Tribunais de Justiça dos Estados*) concur with the strict, joint and several nature of environmental liability as declared by the Superior Court of Justice.<sup>17</sup> For instance, in a case presented before the court of appeals of the state of Rio Grande do Sul,<sup>18</sup> where the improper use of fire to clear native vegetation resulted in grave environmental damage, the judges

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de direito público ou privado, responsável, direta ou indiretamente, por atividade causadora de degradação ambiental.”).

<sup>14</sup> BLACK’S LAW DICTIONARY, *supra* note 11, at 997.

<sup>15</sup> See DANIEL A. FABER ET AL., CASES AND MATERIALS ON ENVIRONMENTAL LAW 891 (2010).

<sup>16</sup> S.T.J., REsp 1056540, Relator: Min. Eliana Calmon, 16.05.2008, R.S.T.J., 14.09.2009 (Braz.) (original wording: “A solidariedade nessa hipótese decorre da dicção dos arts. 3º, inc. IV, e 14, § 1º, da Lei 6.398/1981 (Lei da Política Nacional do Meio Ambiente).”).

<sup>17</sup> In addition to Federal Statutes, courts have jurisdiction to decide environmental harms with effects that are limited to the territory of the state. The analysis here focuses on the federal law, even though the states and municipalities also have power to protect the environment. C.F. Oct. 15, 1988, art. 23 (Braz.). Federal legislation also contemplates criminal sanctions relative to environmental protection, which is not addressed here.

<sup>18</sup> The state courts of Rio Grande do Sul are nationally recognized for their cutting-edge, modern and tailored decisions.

unanimously decided that the plaintiff could freely decide which defendant to target for environmental remediation or compensation purposes. The decision, indeed, states that the selection of defendants is at the Public Ministry's discretion and any request for joinder of parties is not acceptable. The defendant could not even raise the issue of basis for apportionment, since under Brazilian law a single defendant can be held strictly, jointly and severally liable for the entire harm. In the view of Brazilian law, the defendant's right to sue responsible parties for contribution can only be sought in a different action, where the defendant held liable can assert culpability and legal theories of cost allocation. The judge in charge of the report supported his decision, stating:

[I]n cases where the law imposes strict liability, as in matters related to the environment . . . the fault of a third party will never enter into the discussion in the same action . . . because the secondary claim (based on culpability) does not concern in the solution of the main claim (based on strict liability).<sup>19</sup>

Lenders can be considered indirect polluters because the only legal elements required to establish damages are injury and causation. On interpretation of this standard is that causation would be established when the result would not have occurred without the party's conduct or if the defendant's conduct is an important or significant contributor to the injuries. Because credit is an essential prerequisite to the realization of large initiatives, a lender would fall within this standard.

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<sup>19</sup> T.J.R.S, Ap. Civ. No. 70032034183, Relator: Des. Carlos Roberto Lofego Canibal, 16.12.2009, Diário da Justiça do Rio Grande do Sul [D.J.R.S.], 8.2.2010 (Braz.) (quoting HUGO NIGRO MAZZILI, *A DEFESA DOS INTERESSES DIFUSOS EM JUÍZO*, 260 (18th ed. 2005)) (original wording: "No caso, porém, em que a lei imponha responsabilidade objetiva, como em matéria relativa ao meio ambiente . . . não se admitirá a discussão da culpa de terceiro, nos mesmos autos da ação . . . porque a lide secundária (fundada na culpa) não interessa à solução da lide principal (fundada na responsabilidade objetiva).").

Furthermore, unlike cases of corporate loans, in project finance deals, the connection between the lender and the activity that causes harm is much more substantial, as illustrated by the terms of the international Basel II Framework<sup>20</sup> for use by national bank regulators in assessing the capital adequacy of regulated financial institutions:

Project finance (PF) is a method of funding in which the lender looks primarily to the revenues generated by a single project, both as the source of repayment and as security for the exposure . . . . In such transactions, the lender is usually paid solely or almost exclusively out of the money generated by the contracts for the facility's output, such as the electricity sold by a power plant. The borrower is usually an SPE [Special Purpose Entity] that is not permitted to perform any function other than developing, owning, and operating the installation. The consequence is that repayment depends primarily on the project's cash flow and on the collateral value of the project's assets . . . .<sup>21</sup>

A further foundation of the emerging doctrine of environmental lender liability in Brazil arises from Brazil's Constitution. The Brazilian Constitution provides that both "[t]he government and the community have the duty to defend and preserve [the ecologically balanced environment] for present and future generations."<sup>22</sup> Since lenders are members of the community, they have also the duty to

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<sup>20</sup> BASEL COMM. ON BANKING SUPERVISION, BANK FOR INT'L SETTLEMENTS, INTERNATIONAL CONVERGENCE OF CAPITAL MEASUREMENT AND CAPITAL STANDARDS: A REVISED FRAMEWORK ¶ 2, at 1 (2005), *available at* <http://www.bis.org/publ/bcbs111.pdf> ("In addition, the Revised Framework [Basel II] is intended to promote a more forward-looking approach to capital supervision, one that encourages banks to identify the risks they may face, today and in the future, and to develop or improve their ability to manage those risks.").

<sup>21</sup> *Id.* ¶¶ 221-222, at 49.

<sup>22</sup> C.F. Oct. 15, 1988, art. 225 (Braz.) (original wording: "impondo-se ao poder público e à coletividade o dever de defendê-lo e preservá-lo para as presentes e futuras gerações.").

protect the environment. For that reason, there is a hidden environmental risk to lenders that goes beyond that presented by a traditional due-diligence analyses.

This broad environmental regime threatens lenders. Additionally, there is a risk associated with foreclosed collateral. A financial institution can be called, for example, to remediate contamination of a foreclosed property, a demand that can exceed the amount of the loan. In some instances, lack of causation might be a defense. For example, the credit may not have been directed to the property concerned or to activities related to the harm. But, even in these cases, the duty to repair the environment would be maintained. This understanding is based on the *propter rem* theory, according to which the responsibility to repair would arise from the legal link between the owner of the property and the property itself. Therefore, *propter rem* obligations adhere to the title of the property and are automatically transferred to the future owners. In a decision published in November 2009 by the Superior Court of Justice, where the plaintiff was the State Public Ministry of São Paulo, the defendant, a sugarcane company, was found liable for environmental damages simply because it had acquired a property already damaged by previous owners.<sup>23</sup> The prior owners had completely deforested the property, disrespecting the legal reserve and permanent preservation areas requirements applicable to Brazilian forests.<sup>24</sup> The federal

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<sup>23</sup> S.T.J., REsp 948921, Relator: Min. Herman Benjamin, 23.10.2007, R.S.T.J., 11.11.2009 (Braz.).

<sup>24</sup> The "legal reserve" (*reserva legal*) and "permanent preservation area" (*área de preservação permanente* - APP) are mechanisms that implement the constitutional duty to maintain property with its social and ecological functions, so as to guaranty the sustainable use of natural resources and, among other goals, geological stability and human welfare. For example, in the region where the case at issue was brought, twenty percent of a property's area is subject to the reservation that the vegetation cannot be removed. In the Amazon ecosystem, this percentage reaches eighty percent of a property's area. In addition to this "legal reserve" requirement, there is a further requirement to conserve "permanent preservation area." Land subject to permanent preservations is determined by geography, for example, sensitive areas such as riverbanks. To illustrate, a river up to ten meters in breadth implies thirty meters of permanent preservation area along each of its banks. Only in limited

Superior Court of Justice, through its specialized Section on Public Law, unanimously decided that the sugarcane company was liable, without regard to culpability or causal connection of the defendant's conduct. The Court stated:

It is not proper to speak about culpability or proximate cause as determinative of the duty to restore native vegetation . . . . As the hypothesis is of a *propter rem* obligation, it is unreasonable to question who caused the environmental harm *in casu*, whether it was the current or previous owner, or the culpability of those who did or did not damage the environment.<sup>25</sup>

In its defense, the sugarcane company assured that the harm happened, not only before the transference of the property's title, but in 1983 when the law regulating the issue was not yet in force, and that the conduct was protected as an act that the law had not then condemned as illegal. The Superior Court of Justice rejected this defense with the observation that the innovation brought by the 1989 regulation was not on the creation of the duty to reserve a percentage of the property, but about the duty to make record of it in a public registry through a notary. This court emphasized the need for care to avoid confusion between the creation of the legal duty to preserve the area and the publicity of its condition to third parties.<sup>26</sup>

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instances, such as when the sum of the "permanent preservation area" and the "legal reserve" reaches at least fifty percent of rural property outside the so-called "Legal Amazon," can "permanent preservation areas" be considered as comprising of part of the "legal reserve." Lei No. 4.771, de 15 de Setembro de 1965, D.O.U. de 16.09.1965 (Braz.).

<sup>25</sup> S.T.J., REsp 948921, Relator: Min. Herman Benjamin, 23.10.2007, R.S.T.J., 11.11.2009 (Braz.) (original wording: "Descabe falar em culpa ou nexo causal, como fatores determinantes do dever de recuperar a vegetação nativa . . . . Sendo a hipótese de obrigação *propter rem*, desarrazoado perquirir quem causou o dano ambiental *in casu*, se o atual proprietário ou os anteriores, ou a culpabilidade de quem o fez ou deixou de fazer.").

<sup>26</sup> *Id.* ("A inovação que trouxe não foi quanto à instituição da obrigação de conservar a Reserva Legal, mas simplesmente de averbá-la no registro imobiliário. Há, aqui, de ter cuidado para não confundir a *criação de dever legal* com a posterior disciplina, pelo legislador, de sua *publicidade perante terceiros*.").

Lenders must be aware of the consequences of this law in at least two crucial ways. First, notwithstanding the provision of a legal duty to register the “legal reserve” before a notary, the effectiveness of this rule is being constantly postponed. In December 2009,<sup>27</sup> the due date was once again extended to June 11, 2011 as a consequence of the increased demands on already overwhelmed environmental agencies—which have the duty initially to approve the localization of the “legal reserve” area—and the strong agribusiness lobby in Brazil’s Congress—which is working on proposed legislation to update Brazil’s Forestry Code.<sup>28</sup> As a result, the definition of appropriate collateral is even more complex due to uncertainties regarding the actual value of the property. There is no reliable source to find out what is the percentage of the land that can be economically exploited. For instance, as of November 2009, according to the Brazilian National Confederation of Agriculture (*Confederação Nacional da Agricultura* – CNA), less than ten percent of properties subject to the “legal reserve” are now registered before a notary. The president of this confederation points out that the majority of rural producers do not register the “legal reserve” because they simply do not have it preserved.<sup>29</sup> Second, after a foreclosure, the lender can be surprised by a legal duty to not only assume the cost of restoring the vegetation, but also to accomplish the public registration. In fact, an investigation by the leading Brazilian newspaper *Folha de São Paulo* demonstrated that the Superior Court of Justice has clearly changed its approach on deforestation. Ten years ago, the court did not require owners to restore the “legal reserve.” In an article published in November 2009, that newspaper also observed that while Brazil’s Federal Government delays penalties for irregular properties, the

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<sup>27</sup> Decreto No. 7.029, de 10 de Dezembro de 2009, D.O.U. de 11.12.2009 (Braz.).

<sup>28</sup> See, e.g., Projeto de Lei No. 6.424/2005, de 14 de Dezembro de 2005 (Braz.), available at <http://www.camara.gov.br/sileg/integras/365049.pdf>.

<sup>29</sup> See Marta Salomon, *Mais de 90% dos proprietários rurais não registram reserva legal* [Over 90% of Landowners Don’t Register the Legal Reserve], *FOLHA DE SÃO PAULO* (Nov. 30, 2009), <http://www1.folha.uol.com.br/folha/ambiente/ult10007u659452.shtml>.

Superior Court of Justice had begun to mandate the environmental restoration.<sup>30</sup>

The manner in which the Superior Court of Justice decided to fully implement this law is an important instrument to address unsustainable land-use practices and deforestation, which are the most serious Brazilian contributions to global warming. Brazil is ranked the eighth country in total greenhouse gas (GHG) emissions.<sup>31</sup> Indeed, judge Herman Benjamin of the Superior Court of Justice, who has built his distinguished legal career working mainly with environmental law,<sup>32</sup> has demonstrated his concern with climate change related cases, such as in the one previously presented in this study regarding a mangrove forest. In this case, he states:

Everyone has the duty, whether they are property owners or not, to guard the preservation of mangroves, a necessity even greater in times of climate change and the rising of sea levels. The destruction of mangroves for direct economic use, under the constant encouragement of easy money and short-term benefits . . . [of] specula-

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<sup>30</sup> See Marta Salomon, *Justiça ignora adiamento de Lula e pune desmatadores de reserva legal* [Justice Ignores President Lula's Postponment and Punishes Loggers of the Legal Reserve], FOLHA DE SÃO PAULO (Nov. 30, 2009) <http://www1.folha.uol.com.br/folha/ambiente/ult10007u659447.shtml>.

<sup>31</sup> CHRIS WOLD ET AL., CLIMATE CHANGE AND THE LAW 135 (2009).

<sup>32</sup> Professor Antônio Herman de Vasconcellos e Benjamin was appointed as justice of the Superior Court of Justice in 2006. He became one of the nine justices of the Superior Court of Justice responsible for public law decisions. He is the founder and co-editor in chief of the *Brazilian Environmental Law Journal*, the only regular environmental law review in Latin America. He teaches Environmental Law and Products Liability in both Brazil and the United States, including the last 15 years as a regular visiting professor of environmental law at the University of Texas at Austin. He also taught at the University of Illinois from 1999 to 2001. Professor Benjamin has been a member of the UN Legal Experts Committee on Crimes against the Environment and the IUCN Environmental Law Commission. He is the founder and a director of Law for a Green Planet Institute, a leading Brazilian environmental law organization. *Antonio Herman de Vasconcellos e Benjamin*, SUPERIOR TRIBUNAL DE JUSTIÇA, [http://www.stj.jus.br/web/verCurriculoMinistro?cod\\_matriculamin=0001184&imIn](http://www.stj.jus.br/web/verCurriculoMinistro?cod_matriculamin=0001184&imIn) (last visited Jan. 28, 2011); see also Seminar Speaker Information, Antonio Herman Benjamin, Inter-Am. Dev. Bank, available at <http://www.iadb.org/biz/agenda/Benjamin.pdf>.

tive real state . . . feature[s] as serious harm to an ecologically balanced environment and to the welfare of the community, which conduct shall be promptly and intensely restrained and sanctioned by the Government and the Judiciary.<sup>33</sup>

Adding this climate change concern to the reasoning of courts, it is certainly foreseeable that the following statement placed in the decision of the above sugarcane case will be an important source for future decisions on deforestation:

First, ownership is a source of rights and duties. Second, those who acquire a property [already] illegally deforested, or with other irregularities before the environmental law protection, receive it not only with its positive attributes and betterments, but also with the environmental burdens, including the duty to recover the native vegetation of the [l]egal [r]eserve and the [p]ermanent [p]reservation [a]rea.<sup>34</sup>

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<sup>33</sup> S.T.J.-T2, REsp 650728, Realtor: Min. Benjamin Herman, 23.10.2007, R.S.T.J., 02.12.2009 (Braz.) (original wording: “É dever de todos, proprietários ou não, zelar pela preservação dos manguezais, necessidade cada vez maior, sobretudo em época de mudanças climáticas e aumento do nível do mar. Destruí-los para uso econômico direto, sob o permanente incentivo do lucro fácil e de benefícios de curto prazo . . . [de] especulação imobiliária . . . caracterizam ofensa grave ao meio ambiente ecologicamente equilibrado e ao bem-estar da coletividade, comportamento que deve ser pronta e energicamente coibido e apenado pela Administração e pelo Judiciário.”).

<sup>34</sup> S.T.J.-T2, REsp 948921, Min. Herman Benjamin, 23.10.2007, R.S.T.J., 11.11.2009 (Braz.) (original wording: “Primeiro, a propriedade é fonte de direitos, e também de deveres. Segundo, quem adquire imóvel desmatado ilegalmente, ou com irregularidades perante a legislação de proteção do meio ambiente, recebe-o não só com seus atributos positivos e benfeitorias, como também com os ônus ambientais que sobre ele incidam, inclusive o dever de recuperar a vegetação nativa da Reserva Legal e das Áreas de Preservação Permanente.”).



Notably, the Latin risk theory *ubi emolumentum ibi onus*<sup>35</sup> has influenced the development of the Brazilian environmental liability. Under this theory, the one who benefits from the environmental resource should also bear the related risk. Moreover, since in general environmental harm is “indivisible,” Brazilian courts have recognized that joint and several liability is a better answer to address the environmental goals set by Article 225 of Brazil’s Federal Constitution, which is the heart of the Brazilian environmental liability:

Everyone has the right to an ecologically balanced environment, which is a public good for people’s use and is essential for a healthy quality of life, and *both the government and the community* have the duty to defend and preserve it for present and future generations . . . Conduct and activities considered harmful to the environment shall subject the violators, be they individuals or legal entities, to criminal and administrative penalties, without prejudice to the *obligation to repair the harm*.<sup>36</sup>

Besides setting forth a mandate to the legislature to take action, the Federal Constitution established the defense of the environment as a fundamental social right with a constitutional claim for compensation.<sup>37</sup> Statutes adopted before the current Federal Constitution of 1988, such as the National Environmental Policy Act

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<sup>35</sup> “Where the advantage is, there is the burden or disadvantage.” JOHN TRAYNER, *LATIN MAXIMS AND PHRASES* 594-95 (3d ed. 1883).

<sup>36</sup> C.F. Oct. 15, 1988, art. 225 (Braz.) (emphasis added) (original wording: “Todos têm direito ao meio ambiente ecologicamente equilibrado, bem de uso comum do povo e essencial à sadia qualidade de vida, impondo-se ao Poder Público e à coletividade o dever de defendê-lo e preservá-lo para as presentes e futuras gerações. . . . As condutas e atividades consideradas lesivas ao meio ambiente sujeitarão os infratores, pessoas físicas ou jurídicas, a sanções penais e administrativas, independentemente da obrigação de reparar os danos causados.”).

<sup>37</sup> See Ernst Brandl & Hartwin Bungert, *Constitutional Entrenchment of Environmental Protection: A Comparative Analysis of Experiences Abroad*, 16 HARV. ENVTL. L. REV. 1, 83 (1992).

of 1981, have been embraced by Brazilian courts in a protective manner.

Additionally, despite the constitutional provision for compensation under the chapter of social rights, a private right to recover damages is still valid in the Brazilian legal system.<sup>38</sup> Notwithstanding that the protection of rights of this nature under the traditional tort law theories of fault remains valid, Brazilian legal doctrine also supports the application of strict liability in case of private claims for environmental damages.<sup>39</sup> This understanding finds ground in Article 14 of the National Environmental Policy Act, which includes not only the environment, a right held by the society, but also affected third parties as beneficiaries of the strict liability scheme.<sup>40</sup> However, as noted earlier, Brazil's 1988 Constitutional Assembly recognized that the use of civil liability in an environmental context should not be limited to the protection of private interests. This position aimed, for example, to avoid the limitations of torts that do not reflect the full cost of the damage caused to the environment, where a loss suffered by an individual would not result in a sufficient compensation able to fully fund the environmental recovery. Further, in the absence of an individual victim, the Constitution would not prevent third parties concerned with, or in charge of, environmental

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<sup>38</sup> See Lei No. 5.869, de 11 de Janeiro de 1973, D.O.U. de 27.07.2006 (Braz.). Private parties may have their interests protected by an ordinary civil action, as long as all lawsuit requirements are met. These requirements are "legal possibility" (when there is a legal provision protecting the private interest, not limited to property rights), "legitimacy of the parties" (requiring the plaintiff demonstrate that he/she is acting on behalf of his/her own interests and not representing a third party, similar to the American concept of "standing"), and "procedural interest" (ability of the court to render a decision that can cure the harm, similar to the American concept "redressability"). *Id.*

<sup>39</sup> See Vladimir Passos de Freitas, *Ação Civil Pública e o Dano Individual [Public Civil Action and the Private Harm]*, in *A AÇÃO CIVIL PÚBLICA APÓS 20 ANOS: EFETIVIDADE E DESAFIOS [PUBLIC CIVIL ACTION AFTER 20 YEARS: CHALLENGES AND EFFECTIVENESS]* 591, 594 (2005).

<sup>40</sup> See Lei No. 6.938, de 31 Agosto de 1981, D.O.U. de 02.09.1981 (Braz.).

protection to pursue civil claims on behalf of the environment on its own right.<sup>41</sup>

As a result, the Brazilian constitutional provision regarding environmental protection is extremely long, detailed, and expansive.<sup>42</sup> Also, unlike other legal systems, Brazil does not enunciate a right to a healthy or clean environment. Rather, when expressing a right to an *ecologically balanced environment*, Brazil's Federal Constitution implies that "nature is to be valued for its own sake," recognizing "limits to growth" and the necessity of preserving the "balance of nature," and rejects "the anthropocentric notion that nature exists solely for human use."<sup>43</sup>

However, constitutional provisions go beyond this idyllic concept and place environmental protection under the title regarding the economic and financial order. As a result, the idea of balancing constitutional values is strengthened by the wording of article 170 that states:

The economic order, founded on the appreciation of the value of human work and on free enterprise, is intended to ensure everyone a life with dignity, in accordance with the dictates of social justice, with due regard for the following principles: . . . the social function of property; . . . *environmental protection*, including by differentiated treatment in accordance with the environmental impact of products and services and their respective production and rendering.<sup>44</sup>

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<sup>41</sup> The transaction costs associated with establishing a defendant's liability would also constrain the role of traditional tort law as a means for environmental protection. MARK WILDE, *CIVIL LIABILITY FOR ENVIRONMENTAL DAMAGE: A COMPARATIVE ANALYSIS OF LAW AND POLICY IN EUROPE AND THE UNITED STATES* 55 (2002).

<sup>42</sup> See Brandl & Bunker, *supra* note 37, at 75.

<sup>43</sup> Jonathan Cannon, *Environmentalism and the Supreme Court: A Cultural Analysis*, 33 *ECOLOGY L.Q.* 363, 368 (2006) (describing what some sociologists identify as a new environmental worldview or paradigm) (citing Riley E. Dunlap & Kent D. Van Liere, *The New Environmental Paradigm*, 9 *J. ENVTL. EDUC.* 10 (1978))).

<sup>44</sup> C.F. Oct. 15, 1988, art. 170 (Braz.) (emphasis added) (original wording: "A ordem econômica, fundada na valorização do trabalho humano e na livre iniciativa, tem por fim assegurar a todos existência digna, conforme os ditames da justiça social,

Therefore, neither the environment nor development should be an exclusive goal for the government or society. Indeed, the Federal Constitution makes environmental protection a legal concern for government and society to be considered just as they consider other matters. Notwithstanding that the conciliation between environmental protection and a free-enterprise economy represents a thorny mission, Justice Herman Benjamin advertises that there is no conflict between these constitutional values, since "the free enterprise is not self-governing. It can only be qualified as 'free' if it satisfies other constitutional principles, such as solidarity, which is the opposite of the egocentrism recommended by [a] savage capitalism [model]."45

***B. Standing: Public Ministry and Environmental Groups as Key Players***

Not only has Brazil decided to constitutionalize its environmental goals explicitly, but this country has also incorporated exhaustive provisions on standing as a strategy to better guaranty the respect of these constitutional values. The Federal Constitution confers civil standing on public prosecutors, comprised of members of Federal and State Public Ministries. The most common—and efficient—judicial proceeding applied to pursue damages due as a result of an environmental harm is the public civil action (*ação civil pública*). Article 129 of the Federal Constitution reads:

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observados os seguintes princípios: . . . função social da propriedade; . . . defesa do meio ambiente, inclusive mediante tratamento diferenciado conforme o impacto ambiental dos produtos e serviços e de seus processos de elaboração e prestação . . .").

<sup>45</sup> *Atuação destacada do Judiciário favorece desenvolvimento de Direito Ambiental no Brasil* [Outstanding Performance of the Judiciary Favors Development of Environmental Law in Brazil], SUPERIOR TRIBUNAL DE JUSTIÇA (Jun. 5, 2010), [http://www.stj.gov.br/portal\\_stj/publicacao/engine.wsp?tmp.area=398&tmp.texto=97557](http://www.stj.gov.br/portal_stj/publicacao/engine.wsp?tmp.area=398&tmp.texto=97557) (original wording: "a livre iniciativa não é irrestritamente 'livre'. Ela só é livre se cumpre outros princípios previstos na própria Constituição como a solidariedade, que é o oposto do egocentrismo preconizado pelo capitalismo selvagem . . .").

The following are institutional functions of the Public Ministry: . . . to *institute civil investigation and public civil action* to protect . . . the environment and other diffuse and collective interests; . . . The standing of the Public Prosecution for the civil actions . . . shall *not preclude those of third parties in the same cases* . . .<sup>46</sup>

Called the greatest institutional novelty of the 1988 Constitution,<sup>47</sup> the Public Ministry received independence from the executive branch as necessary to fulfill its leading role in the protection of the new set of diffuse and collective rights.<sup>48</sup> As stated by a former member of the Constitutional Assembly of 1988:

[W]e are creating an organ outside the scheme of the three powers. It is an organ of enforcement that does not fit any of the branches of Montesquieu's scheme. Why are we proposing financial, political, and administrative

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<sup>46</sup> C.F. Oct. 15, 1988, art. 129 (Braz.) (emphasis added) (original wording: "São funções institucionais do Ministério Público: . . . promover o inquérito civil e a ação civil pública, para a proteção . . . do meio ambiente e de outros interesses difusos e coletivos; . . . A legitimação do Ministério Público para as ações civis previstas neste artigo não impede a de terceiros, nas mesmas hipóteses . . .").

<sup>47</sup> LESLEY K. MCALLISTER, MAKING LAW MATTER: ENVIRONMENTAL PROTECTION AND LEGAL INSTITUTIONS IN BRAZIL 71 (2008) [hereinafter MCALLISTER, MAKING LAW MATTER]. Although public prosecutors have been empowered to file lawsuits for environmental harm since the mid-1980s', the 1988 Constitution granted the Public Ministry administrative, political, financial, and budget-making autonomy. *Id.* at 16-17, 71-72.

<sup>48</sup> "In Brazilian law, 'diffuse interests' are interests held by an indeterminable number of people or society as a whole [such as the right to an "ecologically balanced environment"], while 'collective interests' refer to those of an identifiable group of people [such as the rights of a determinate community affected by hazardous waste]." *Id.* at 4 n. 5; *see also* Lei No. 8.078 art. 81(I)-(II), de 11 de Setembro de 1990, D.O.U. de 12.09.1990 (Braz.). Under Brazil's law, the term 'public interests' is related to both diffuse and collective rights, having different connotation from the one applied in the United States, where public interests refer to the interests of the state rather than society.

autonomy for this organ? Because we want a strong agent of legal enforcement.<sup>49</sup>

Under this new legal framework, Brazilian prosecutors became central actors in environmental enforcement, changing the prevailing notion that powerful economic and political actors could violate environmental law with impunity.<sup>50</sup> In that regard, notwithstanding the clear linkage between “prosecutorial environmental enforcement” and the judiciary,<sup>51</sup> it is not rare to see members of the Public Ministry achieving their goals extrajudicially.

In this direction, once an environmental civil investigation is mature,<sup>52</sup> the prosecutor usually seeks for settlement before presenting the case to court. Because these settlement agreements—so-called “conduct adjustment agreements”<sup>53</sup>—not only avoid the time and expenses associated with the judicial system, but also represent a more cooperative and less adversarial enforcement process; they

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<sup>49</sup> McAllister, MAKING LAW MATTER, *supra* note 47, at 57 (quoting Plínio de Arruda Sampaio (cited in Fábio Kerche, *O Ministério Público e a Constituinte de 1987/88* [The Public Ministry and the Constitutional Assembly of 1987/88], in O SISTEMA DE JUSTIÇA [THE JUSTICE SYSTEM] (Maria Tereza Sadek ed., 1998)). Plínio de Arruda Sampaio is still active in Brazil's political scenario.

<sup>50</sup> “Prosecutors view themselves as the representatives of societal interests, rather than governmental interests.” Lesley K. McAllister, *Revisiting a “Promising Institution”: Public Law Litigation in the Civil Law World*, 24 GA. ST. U. L. REV. 693, 703 (2008) [hereinafter McAllister, *Promising Institution*].

<sup>51</sup> Lesley K. McAllister, *On Environmental Enforcement and Compliance: a Reply to Professor Crawford's Review of Making Law Matter: Environmental Protection and Legal Institutions in Brazil*, 40 GEO. WASH. INT'L L. REV. 649, 650 (2009) [hereinafter McAllister, *Environmental Enforcement*].

<sup>52</sup> While criminal investigations are led by the policy, the civil investigations are a responsibility of the members of the Public Ministry.

<sup>53</sup> “Conduct Adjustment Agreements” is a translation for “*Compromisso de Ajustamento de Conduta*” or “*Termo de Ajustamento de Conduta*”, which are broadly recognized in Brazil by the acronym “TAC”. See Lei No. 7.347, de 24 de Julho de 1985, D.O.U. de 25.07.1985 (Braz.).

have been identified by members of the Public Ministry as “the most efficient option for both remediation and prevention of harm.”<sup>54</sup>

Especially through the negotiation of conduct adjustment agreements, the Public Ministry has consolidated its vocation to serve as a forum for dispute resolution.<sup>55</sup> Relying on techniques of negotiation, this conciliatory approach may “allow for the continuation of some arguably illegal behavior with the promise of compliance after a certain time period or perhaps as a concession made in the course of gaining other commitments.”<sup>56</sup> However, it is important to note that as prosecutors are dealing with trans-individual rights,<sup>57</sup> they may only negotiate conditions of the deal, such as time, place, and methods of compliance. There is no possibility to negotiate, for example, the extent of the remediation. This “give-and-take” or “reasonableness” strategy seeks to promote the development of custom-built remedies that would not likely be achieved through the judicial process.<sup>58</sup>

Due to the quasi-contractual nature of these agreements,<sup>59</sup> the request of a financial guarantee as a condition for the deal is emerging as a trend among public prosecutor negotiators. The settlement following one of Brazil’s most serious environmental accidents illustrates the trend. In 2006, the release of two billion liters

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<sup>54</sup> McAllister, MAKING LAW MATTER, *supra* note 47, at 91 (quoting Antonio A. M. de Camargo Ferraz & João L. Guimarães Júnior, *A Necessária Elaboração de uma Nova Doutrina de Ministério Público Compatível com seu Atual Perfil Constitucional* [The Necessary Preparation of a New Doctrine of Public Prosecution Compatible with its Current Constitutional Profile], in MINISTÉRIO PÚBLICO: INSTITUIÇÃO E PROCESSO [PUBLIC PROSECUTOR: ESTABLISHMENT AND PROCEDURE] (Antonio A. M. de Camargo Ferraz ed., 1999)).

<sup>55</sup> *Id.* at 153.

<sup>56</sup> McAllister, *Environmental Enforcement*, *supra* note 51, at 669.

<sup>57</sup> See Lei No. 8.078 art. 81(I)-(II), *supra* note 48 and accompanying text.

<sup>58</sup> See McAllister, *Environmental Enforcement*, *supra* note 51, at 669.

<sup>59</sup> Conduct adjustment agreements are not under the category of contracts since the Public Ministry has no power of disposal of “transindividual rights”. See Hugo N. Mazzilli, *Compromisso de Ajustamento de Conduta: Evolução, Fragilidades e Atuação do Ministério Público* [Conduct Adjustment Agreements: Evolution, Weaknesses, and the Public Ministry’s Performance], 41 REVISTA DE DIREITO AMBIENTAL [J. ENVTL. L.] 104, 104 (2006); See also A Lei 10.406, de 10 de Janeiro de 2002, D.O.U. de 11.1.2002 (Braz.); Código Civil [C.C.] art. 841 (Braz.).

of mining waste, from the rupture of tailing dams, displaced thousands of people, inundated cultivated lands, and interrupted the water supply of cities located in the states of Rio de Janeiro (Northwest region) and Minas Gerais (*Zona da Mata* area).<sup>60</sup> Through a task force led by both the Federal Public Ministry and prosecutors of the states of Rio de Janeiro and Minas Gerais, a conduct adjustment agreement formalized the environmental covenants undertaken by the mining company. As a guarantee for the compliance with the covenants of the agreement, a bank account was opened to receive the deposit of a security.<sup>61</sup> Bank guarantees, particularly the so-called *fiança*,<sup>62</sup> may also comprise the collateral to assure performance of "conduct adjustment agreements."

Financial institutions should be aware that conduct adjustment agreements are instruments still under maturation. These settlements demand particular attention from project finance lenders. First, it is common to observe that, in general, conduct adjustment agreements typically include an extensive list of positive and negative covenants, but one straightforward general clause entitling the Public Ministry to declare the conduct adjustment agreement in default in the event of noncompliance. These characteristics may blur the circumstances in which the Public Ministry is entitled to declare a default, with the consequence that any collateral becomes due and payable. Moreover, because the Public Ministry acts as the

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<sup>60</sup> See Universidade Federal de Viçosa, *Impacto Ambiental Relevante na Bacia do Rio Paraíba do Sul em Minas Gerais—Rompimento de Barragem de Rejeitos* [Relevant Environmental Impact in the Paraíba do Sul River Basin in Minas Gerais – Rupture of Tailing Dam], ATLAS DIGITAL DAS ÁGUAS DE MINAS [DIGITAL ATLAS OF THE MINE WATERS], [http://www.atlasdasaguas.ufv.br/paraiba/impacto\\_ambiental\\_relevante\\_na\\_bacia\\_do\\_rio\\_paraiba\\_do\\_sul\\_em\\_minas\\_gerais.html](http://www.atlasdasaguas.ufv.br/paraiba/impacto_ambiental_relevante_na_bacia_do_rio_paraiba_do_sul_em_minas_gerais.html) (last visited Jun. 17, 2010).

<sup>61</sup> See Instituto Estadual de Florestas, *Rio Pomba Assina Termo de Ajustamento de Conduta* [Rio Pomba signs Conduct Adjustment Agreement], PORTAL DO GOVERNO DE MINAS GERAIS [GOV'T PORTAL OF MINAS GIRAIS], <http://www.ief.mg.gov.br/noticias/1/188-rio-pomba-assina-termo-de-ajustamento-de-conduta> (last visited Jun. 17, 2010).

<sup>62</sup> See C.C. art. 818 (Braz.).



“watchdog” of the law,<sup>63</sup> it is quite unlikely to exercise discretion in forbearing from making a declaration of default, even if the breach of the agreement is arguably not a material one. Second, project finance lenders operating in Brazil usually rely on these settlement agreements as evidence to support contractual warranties regarding, for example, the likelihood of environmental claims. Actually, compliance with a robust conduct adjustment agreement preempts further lawsuits brought by the contracting party related to the object of the deal. However, as these agreements are not yet mature, common shortcomings, such as short-term solutions or technically inadequate covenants,<sup>64</sup> may jeopardize the expected effects of the deal. In fact, conduct adjustment agreements are taken under the so-called *rebus sic stantibus* (“matters so standing”)<sup>65</sup> condition. For instance, a settlement agreement can be challenged before a court if further environmental assessment demonstrates that control technologies agreed in the deal are not capable of properly addressing harmful effects of the activity. Hence, if further elements join the initial object of the agreement, a resultant broader object is not subject to the initial preemption and the case can be brought before a court. Third, as the effects of conduct adjustment agreements apply among contracting parties, there is no impediment to other actors with standing, unsatisfied with the terms of the settlement, challenging the polluter directly in court in the case of private players, and in the case of governmental entities, challenging the polluter either through extrajudicial instruments or through usual judicial proceedings. As the current doctrine teaches,<sup>66</sup> conduct adjustment agreements are a minimum guarantee in favor of society and cannot impede the access of plaintiffs to other available remedies. Moreover, because these quasi-contracts are made in favor of the community and not in favor

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<sup>63</sup> Expression suggested by Lesley K. McAllister. See McAllister, *Environmental Enforcement*, *supra* note 51, at 660.

<sup>64</sup> Nevertheless, the creation of “Environmental Prosecution Support Centers,” which, provide environmental technical knowledge for prosecutors, is noteworthy. Prosecutors essentially base their negotiations on legal matters.

<sup>65</sup> See TRAYNER, *supra* note 35, at 543.

<sup>66</sup> See Mazzilli, *supra* note 59, at 108-10.

of the contracting entity (in this case the Public Ministry), other actors with standing may enforce the agreement judicially.

According to a 2009 study fund by the World Bank, from 1992 until mid-1998, the Federal Public Ministry agreed on 39 conduct adjustment agreements related to environmental protection. However, this number has grown exponentially in the last decade. From 2000 to 2008, the Federal Public Ministry has made almost 500 conduct adjustment agreements. In addition, state prosecutors from Brazil's Southeast and South regions have adopted a similar strategy when pursuing environmental enforcement. For instance, the state of São Paulo Public Ministry makes about 600 conduct adjustment agreements per year.<sup>67</sup>

Notwithstanding these impressive numbers, "public civil actions" are still the Public Ministry's flagship instrument. From 2006 to 2008, 65% of the environmental enforcement conducted by the Federal Public Ministry has been accomplished through these lawsuits. Prosecutors identify the influence some entrepreneurs have within environmental agencies as one of the reasons that usually makes a conduct adjustment agreement unviable. The entrepreneur sometimes has the confidence that the environmental agency will issue or renew a permit regardless of the illegal situation. As a result, a lawsuit emerges as the only viable environmental enforcement instrument.<sup>68</sup>

Additionally, as conduct adjustment agreements establish the polluter's admission of causing the harm and the acceptance of the stated penalty, their effects simplify the enforcement of the

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<sup>67</sup> See Instituto o Direito Por Um Planeta Verde [Law for a Green Planet Institute], *Compromisso de Ajustamento Ambiental: Análise e Sugestões para Aprimoramento* [Environmental Adjustment Agreements: Analysis and Suggestions for Improvement], 65-77 (2009), available at [http://www.mp.ba.gov.br/atuacao/ceama/publicacao/2009/compromisso\\_ajustamento\\_ambiental.pdf](http://www.mp.ba.gov.br/atuacao/ceama/publicacao/2009/compromisso_ajustamento_ambiental.pdf).

<sup>68</sup> It is common to see polluters arguing in court that they have been coerced to agree on the terms of the "conduct adjustment agreements" because of the threat of a potential lawsuit. However, this argument conflicts with the law which states that the regular practice of a right cannot be considered a coercion. See *id.* at 39, 73-75. See also CÓDIGO CIVIL [C.C.] art. 153 (Braz.).

agreement in court in the case of noncompliance.<sup>69</sup> In this context, without regard to financial guarantees, there is no need to produce any kind of evidence and “[s]uch lawsuits are won almost automatically.”<sup>70</sup> This is one reason why some defendants reject the opportunity to settle by means of a conduct adjustment agreement, preferring to contest the case directly before a court.<sup>71</sup>

Brazilian scholars support that where the environmental harm is unequivocal and the extrajudicial settlement has not been achieved, the Public Ministry must file a public civil action in order to impose civil liability or to prevent environmental harm.<sup>72</sup> As there is no need to establish actual damage caused, prosecutors will routinely take preventive actions to compensate failures of administrative control. Hence, the duty to bring a lawsuit where there is an environmentally threatening activity is clearly associated with the active role played by the Public Ministry when, for example, questioning major infrastructure projects. When acting preventively, prosecutors usually resort to seeking preliminary injunctions. Under Brazilian civil procedure law, if the delay of the judicial response may result in an irreparable damage and the plaintiff is able to demonstrate the verisimilitude of the claim, a preliminary injunction can be requested.<sup>73</sup> According to the Superior Court of Justice, temporary injunctions, in general, can be granted even before the defendant has the opportunity to be heard. In a 2001 unanimous decision regarding

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<sup>69</sup> McAllister, MAKING LAW MATTER, *supra* note 47, at 91.

<sup>70</sup> *See Id.* The enforcement of the agreement is sought through an ordinary action.

<sup>71</sup> “While a popular image abounds of the prosecutor as the ‘people’s true defender’, there is another widespread image of the prosecutor as the ‘irresponsible exhibitionist.’” McAllister, MAKING LAW MATTER, *supra* note 47, at 188 (citing Maria Tereza Sadek & Rosangela Batista Cavalcanti, *The New Brazilian Public Prosecution: An Agent of Accountability*, in DEMOCRATIC ACCOUNTABILITY IN LATIN AMERICA 221 (Scott Mainwaring & Christopher Welna eds., 2003). The structure of Brazilian Public Ministry, which is a specialized, nonelective, and autonomous institution, opens possibilities for abuse of prosecutorial power. *Id.*

<sup>72</sup> *See* McAllister, MAKING LAW MATTER, *supra* note 47, at 92-93.

<sup>73</sup> In order to have the preliminary injunction granted, the party must present two essential elements before a court: *periculum in mora* (literally “danger in delay”) and *fumus boni iuris* (literally “appearance of good law”). *See* C.P.C., *supra* note 36, art. 273.

temporary injunctions issued before or during a trial, the federal court expressed: “[t]he adoption of precautionary measures (including preliminary injunctions where the other party is not heard) is essential for the proper exercise of the judicial service, which should not face obstacles, apart from those found in the law.”<sup>74</sup> Because the Brazilian judicial structure allows a series of proceedings to seek reconsideration of a decision by a higher authority, injunction battles frequently continue through reviews and reversals until a court has the chance finally to decide the case.

Unlike the legal authority to make conduct adjustment agreements, which is exclusive to public entities,<sup>75</sup> the power to file a suit on environmental damages has been broadly extended to environmental groups. These plaintiffs also rely mainly on the Public Civil Action Law (*Lei de Ação Civil Pública*)<sup>76</sup> which, despite the availability of other instruments,<sup>77</sup> is the most frequent vehicle to

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<sup>74</sup> S.T.J., MC 2136-SC, Relator: Min. José Delgado, 22.5.2001, R.S.T.J., 20.8.2001 (Braz.) (original wording: “A adoção de medidas cautelares (inclusive as liminares *inaudita altera pars*) é fundamental para o próprio exercício da função jurisdicional, que não deve encontrar obstáculos, salvo no ordenamento jurídico.”).

<sup>75</sup> Jointly with the Public Ministry, environmental agencies and many other members of the public administration are among these authorized public entities. All authorized to make “conduct adjustment agreements” have standing to bring public civil actions. See Lei No. 7.347, de 24 de Julho de 1985, D.O.U., de 25.07.1985 (Braz.). However, it is not common to have environmental agencies bringing lawsuits, since they usually prefer to apply administrative penalties—such as fines—instead of going to court as a strategy to enforce environmental law. See McAllister, MAKING LAW MATTER, *supra* note 47, at 93.

<sup>76</sup> Lei No. 7.347, de 24 de Julho de 1985, D.O.U. de 25.07.1985 (Braz.).

<sup>77</sup> Another important statute that regulates standing is the Popular Lawsuit Act (*Lei de Ação Popular*), Lei No. 4.717, de 29 Junho de 1965, D.O.U. de 8.4.1974 (Braz.). The right established in the statute, which was embraced by the Federal Constitution in 1988 as a constitutional remedy under the article of fundamental rights, is not as common or efficient as the Public Civil Suit Act, Lei No. 7.347, de 24 de Julho de 1985, D.O.U. de 25.7.1985 (Braz.). Regarding the people’s legal action, according to the Federal Constitution, “any citizen is a legitimate party to file a people’s legal action with a view to nullifying an act injurious to the public property or to the property of an entity in which the State participates, to the administrative morality, to the environment and to the historic and cultural heritage, and the author shall, save in the case of proven bad faith, be exempt from judicial costs and from the burden of

pursue remediation of, or compensation for, environmental damages in court. According to article 5 of the statute, as amended in 2007, the following have standing to bring public civil action resulting from environmental harm:

I - the Public Ministry. . . .

V - the Association that concurrently:

- a) has been established for at least 1 (one) year in accordance with the civil law; and
- b) includes among its institutional purposes the protection of the environment . . . .

§ 4 - The requirement of [the one year] pre-constitution may be waived by the judge when there is a manifest social interest evidenced by the size or characteristics of the damage or the relevance of the legally protected interest.<sup>78</sup>

The existence of a specific statute authorizing invocation of the judicial process, combined with the broad constitutional right to an “ecologically balanced environment,” makes the question of standing independent of an alleged personal stake in the outcome of the controversy. Based on this liberal standing law, for example, a non-governmental organization (NGO) does not need to demonstrate in court that its members have individualized injuries.<sup>79</sup> While local

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defeat.” C.F. Oct. 15, 1988, art. 5º, LXXIII (original wording: “qualquer cidadão é parte legítima para propor ação popular que vise a anular ato lesivo ao patrimônio público ou de entidade de que o Estado participe, à moralidade administrativa, ao meio ambiente e ao patrimônio histórico e cultural, ficando o autor, salvo comprovada má-fé, isento de custas judiciais e do ônus da sucumbência.”).

<sup>78</sup> Lei No. 7.347, de 24 de Julho de 1985, D.O.U. de 25.07.1985 (Braz.) (original wording: “Têm legitimidade para propor a ação principal e a ação cautelar: I - o Ministério Público . . . V - a associação que, concomitantemente: a) esteja constituída há pelo menos 1 (um) ano nos termos da lei civil; b) inclua, entre suas finalidades institucionais, a proteção ao meio ambiente. . . . § 4.º O requisito da pré-constituição poderá ser dispensado pelo juiz, quando haja manifesto interesse social evidenciado pela dimensão ou característica do dano, ou pela relevância do bem jurídico a ser protegido.”).

<sup>79</sup> See FABER ET AL., *supra* note 15, at 377–379 (quoting *Sierra Club v. Morton*, 405 U.S. 727 (1972)).

and less representative NGOs traditionally prefer to make a complaint to the Public Ministry rather than filing public civil actions themselves,<sup>80</sup> major international environmental groups usually decide to act directly in the case. On the one hand, such broad standing and civil environmental liability regimes largely affect entities that most profit from environmental resources. On the other hand, this Brazilian scheme of environmental protection can be turned into a draconian strategy to look for “deep pocket” defendants, especially financial institutions. Although the lower courts have not yet had the occasion clearly to follow the December 2009 Superior Court of Justice decisions on lender liability, Brazilian Public Prosecutors and NGOs have already figured out how powerful (and threatening) they can be. The three approaches of similar nature that follow illustrate their realization. The first was carried out by an international NGO. The second was performed by Federal and State Public Ministries. Case three was led by local NGOs with the support of international environmental groups.

Case 1: December, 2006

The NGO International Rivers, which is associated with non-governmental organizations constituted under Brazilian Law, wrote a letter to the President of the Inter-American Development Bank (IDB) expressing concerns with the possible participation of this MDB in the financing of the Madeira River Hydroelectric Dam project in Brazil, comprised of the Santo Antonio (3,150 MW) and Jirau (3,450 MW) projects. These projects are part of the larger “IIRSA Project”,<sup>81</sup> intended to promote the development of transport, energy and communications infrastructure in South America. The formal answer provided by the IDB stated that, notwithstanding the environmental

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<sup>80</sup> In the case that less representative environmental groups decide to bring environmental lawsuits themselves, it is common to observe the Public Ministry joining the case as eminent plaintiffs.

<sup>81</sup> INICIATIVA PARA LA INTEGRACIÓN DE LA INFRAESTRUCTURA REGIONAL SURAMERICANA [INITIATIVE FOR THE INTEGRATION OF REGIONAL INFRASTRUCTURE IN SOUTH AMERICA], [www.iirsa.org](http://www.iirsa.org) (last visited Dec. 17, 2010).

concerns communicated by the NGO, the IDB considers not only the domestic law of the host country, but applies in every project higher standards based on its own environmental policies.<sup>82</sup>

Case 2: April, 2009

Federal and State Public Prosecutors started a civil investigation into environmental harms caused by infrastructure projects in Brazil's northeastern State of Bahia. Even though these projects had received all permits needed, engineers contracted by prosecutors concluded that the environmental impact assessment (EIS) was not adequate for the scope of the project. They accordingly filed a suit against local authorities, arguing that permits should be suspended. Meanwhile, prosecutors have formally advised banks that Brazilian law covers financial institutions as liable parties for their clients' environmental harms. They also recommended to the banks that they suspend disbursements to those projects.<sup>83</sup>

Case 3: March, 2010

Twenty-two environmental groups, supported by 47 additional NGOs, including leading organizations such as Greenpeace, WWF Brazil, and Friends of the Earth—Brazil, formally notified the Brazilian Development Bank that this financial institution would be found jointly and severally liable for environmental damages if it were to decide to finance the Belo Monte Hydroelectric dam (11,233 MW). Their grounds are not only in the Brazilian law but also in the argument that the agency responsible for the permitting process, the Brazilian Institute of Environment and Renewable Natural Resources

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<sup>82</sup> See Letter from Alfredo Barechea, External Relations Advisor, Inter-Am. Dev. Bank, to Glenn Switkes, Amazon Program Dir., Int'l Rivers Network (Dec. 13, 2006), *available at* <http://www.amazonia.org.br/arquivos/228569.pdf> (last visited Mar. 7, 2010).

<sup>83</sup> See Letter from Ministério Público Fed. and Ministério Público do Estado da Bahia, to HSBC Bank Braz. (Apr. 27, 2009), *available at* [http://www.prba.mpf.gov.br/mpf-noticias/recomendacao\\_mpf\\_014-2009\\_a\\_instituicao\\_financeira\\_pddu\\_e\\_paralela\\_-\\_banco\\_hsbc\\_.pdf/at\\_download/file](http://www.prba.mpf.gov.br/mpf-noticias/recomendacao_mpf_014-2009_a_instituicao_financeira_pddu_e_paralela_-_banco_hsbc_.pdf/at_download/file) (last visited De. 16, 2010).

(IBAMA), issued the preliminary environmental permit,<sup>84</sup> the first out of three stages in the permitting scheme, without regard to the conclusion of its technical staff which has pointed out that, up to that point, there were not enough elements to certify the environmental viability of the project.<sup>85</sup> Notwithstanding the notification, the Brazilian Development Bank announced in April 2010 its willingness to finance up to 80% of the total project capital cost (US\$ 11 billion) and that environmental costs are among financeable items.<sup>86</sup>

Members of the Public Ministry and NGOs have identified that targeting financial institutions is a viable alternative to pursue their environmental protection goals. As a first measure, they are attempting to effectively—and timely—stop the development of projects by threatening banks and thereby avoiding the overloaded Brazilian judicial system, where the “index of congestion” can reach astonishing average rates of 76.1% in federal trial courts and 59.8% in federal courts of appeal.<sup>87</sup> There is no doubt that, as already demonstrated in the case in which the Brazilian Development Bank

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<sup>84</sup> According to Brazil's environmental regulation, a preliminary environmental permit (*Licença Prévia – LP*) is granted when the environmental agency approves the location and design of the project, certifies that the project is environmentally viable, and establishes basic requirements and conditions to be fulfilled in the next stages of the project's implementation. See Resolução Conama No. 237, de 19 de Dezembro de 1997, D.O.U de 12.22.97 (Braz.).

<sup>85</sup> See Demand Letter from Sindicato dos Trabalhadores e Trabalhadoras Rurais de Senador José Porfírio et al., to Banco Nacional de Desenvolvimento Econômico e Social (Mar. 22, 2010), available at <http://www.amazonia.org.br/arquivos/349285.pdf> (according to this demand letter, the technical staff statement is identified as Nota Técnica do IBAMA No. 04/2010).

<sup>86</sup> See *BNDÉS Define Condições do Apoio à Construção da Hidrelétrica de Belo Monte* [BNDÉS Sets the Conditions for Supporting Construction of Belo Monte Dam], BANCO NACIONAL DE DESENVOLVIMENTO [BRAZILIAN DEVELOPMENT BANK] (Apr. 16, 2010), [http://www.bndes.gov.br/SiteBNDÉS/bndes/bndes\\_pt/Institucional/Sala\\_de\\_Imprensa/Noticias/2010/energia/20100416\\_Belo\\_Monte.html](http://www.bndes.gov.br/SiteBNDÉS/bndes/bndes_pt/Institucional/Sala_de_Imprensa/Noticias/2010/energia/20100416_Belo_Monte.html).

<sup>87</sup> See CONSELHO NACIONAL DE JUSTIÇA [BRAZILIAN NATIONAL COUNSEL OF JUSTICE], [http://www.cnj.jus.br/images/imprensa/justica\\_em\\_numeros\\_2008.pdf](http://www.cnj.jus.br/images/imprensa/justica_em_numeros_2008.pdf) (last visited Mar. 7, 2010) (“Index of congestion” (*Taxa de Congestionamento*) is calculated through the equation  $T = 1 - \text{Sent.} / (CN + Cpj)$ , where *Sent* = Decisions; *CN* = New Cases; *Cpj* = Cases in Backlog).



has been called as defendant, as a second measure, the Public Ministry and NGOs will bring suits against financial institutions demanding damages for environmental harm to their clients. The strict, joint and several liability can be applied in a very harsh and severe manner against financial institutions that have relied solely on the environmental impact assessments, performed by governmental agencies and their permitting proceedings.

Although it is possible to suggest that this alternative approach may positively affect environmental protection in Brazil, the substitution of prosecutorial and judicial actors for a perceived non-responsive public administration is a pathological situation.<sup>88</sup> Moreover, the ambition to have lenders undertake a further kind of responsibility—usually neglected by the bureaucracy—may make Brazil's environmental enforcement structure and its functionality even more irregular. Because environmental problems are technically complex, the substitution of the public administration for other actors would not likely result in efficient environmental protection in the long-run. In fact, systematic enforcement, which can only be accomplished by the public administration, is much more desirable because it is far more effective than sporadic interventions.<sup>89</sup> Additionally, the public administration is the actor able to combine the analysis of cumulative environmental impacts of a project in accordance with future developments in the region. Moreover, other than the public administration, other actors can respond only under specific circumstances and, in many cases, after an environmental harm has already occurred.

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<sup>88</sup> See Patrick Del Duca, *Italian Judicial Activism in Light of French and American Doctrines of Judicial Review and Administrative Decisionmaking: The Case of Air Pollution* 82 (Eur. U. Inst., Working Paper No. 89/386, 1989) (on file with author) [hereinafter Del Duca, *Judicial Activism*].

<sup>89</sup> See Patrick Del Duca, *Il Giudice Italiano e Statunitense: il Contrasto fra Strategie di Sostituzione e di Controllo della pubblica amministrazione* [Activism of Italian Judges with Respect to Acting in Place of the Public Administration], 374 *GIURISDIZIONE E TUTELA DELL'AMBIENTE* 376, 392 (1986).

### *C. Parallel Initiatives of the Government*

Undeniably, due to their active involvement in environmental matters, judges, prosecutors, and NGOs are shaping Brazil's law enforcement. As legal institutions substitute themselves for the public administration, political and economic costs are being imposed on the sustainable development of the country.<sup>90</sup>

In fact, the origins of those instruments now essential for environmental enforcement, namely conduct adjustment agreements and public civil actions, arise in the same context that generated the democratic Constitution of 1988. As that constitution established a new generation of rights, an original scheme based on exercise of diffuse and collective interests to protect them emerged as a necessity. Indeed, this protective scheme arose from the historical inability of the Executive branch to properly organize and direct the public administration.

These historical difficulties are a result of complex factors.<sup>91</sup> First, notwithstanding the adoption of pluralistic democratic politics in the 1980's in reaction to the military dictatorship regime established in 1964, the coalition politics and lack of alternation of the holders of power impeded development of an impartial, competent administration. Although governments change often, the configuration of the governing coalitions is remarkably stable, and because political parties have found in the administrative structure a useful alternative to increase their power, the lack of alternation in political control has proven a fertile ground for patronage.<sup>92</sup> Second, in a country where unemployment, informality, and low wages are common,<sup>93</sup> there is a tendency to see employment in the public

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<sup>90</sup> See Del Duca, *Judicial Activism*, supra note 88, at 1-2.

<sup>91</sup> See Del Duca, *Judicial Activism*, supra note 88, at 6-13. A similar situation has been identified in Italy after World War II.

<sup>92</sup> See Alexei Barrionuevo, *Scandals Puts Pressure on a Brazilian Leader to Step Down*, N.Y. TIMES, August 7, 2009, at A8.

<sup>93</sup> In May 2010, the average wage in main metropolitan areas, such as São Paulo and Rio de Janeiro, was US\$800. *Monthly Survey of Industrial Employment and Wages*, BRAZILIAN INSTITUTE OF GEOGRAPHY AND STATISTICS, available at

administration not only as the only worthwhile career opportunity,<sup>94</sup> but also as a social welfare program.<sup>95</sup> Third, applying an organizational model that is not able to break with a culture of bureaucracy,<sup>96</sup> the public administration fails to correspond to the real necessities of the country. For example, at the 2008 National Conference of the Brazilian Federal Bar Association Council (*OAB Conselho Federal*), its counselor for the state of Amazonas (the largest state in the Amazon region) alarmed the participants with the information that the urban Ibirapuera Park in São Paulo (1.6 km<sup>2</sup>) had—at that time—300 environmental inspectors, exactly the same number of inspectors of the federal environmental agency that were responsible for the entire Brazilian Amazon Forest (approximately 4.2 million km<sup>2</sup>).<sup>97</sup> These numbers, in fact, reflect another reality. Even though the pursuit of a public position attracts about millions of

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<http://www.ibge.gov.br/english/estatistica/indicadores/industria/pimes/default.shtm> (follow “Click here to download all the editions of the Monthly Survey of Industrial Employment and Wages” hyperlink; then follow “pimes\_201005caderno.zip” hyperlink).

<sup>94</sup> After a 3 years tenure period, every employee of the federal public administration who has passed a civil service exam has the right to keep his/her job permanently, except if there is a final judicial or administrative decision against it. Only in 1998, performance assessment has been included as part of the tenure and the basis of this assessment are still under development. *Cf.* C.F. Oct. 15, 1988, art. 40 (Braz.).

<sup>95</sup> For example, in May 2010, Brazilian Senate resumed the discussion regarding a bill that would make unpaid the application for federal civil service exam for unemployed. *See* Projeto de Lei do Senado No. 76/2004 de 1 de Abril de 2004 (Braz.), available at <http://www.senado.gov.br/atividade/materia/getPDF.asp?t=80252&tp=1>.

<sup>96</sup> *See* Leonardo Secchi, *Modelos Organizacionais e Reforma da Administração Pública* [Organizational Models and Public Administration Reform], 43 REVISTA DE ADMINISTRAÇÃO PÚBLICA [RAP] 347, 347 (2009).

<sup>97</sup> *See XX Conferência: Amazônia e Parque do Ibirapuera têm o mesmo número de fiscais* [The Amazon and Ibirapuera Park Have the Same Number of Inspectors], ORDEM DOS ADVOGADOS DO BRASIL—CONSELHO FEDERAL (Nov. 12, 2008), <http://www.oab.org.br/noticia.asp?id=15169>. Ibirapuera Park is managed by the government of the municipality of São Paulo. The numbers of the federal environmental agency is related to the Brazilian Institute of the Environment and Renewable Natural Resources (IBAMA) agency which has the legal assignment, for example, to grant federal environmental permits and control environmental quality. Lei No. 7.735, de 22 de Fevereiro de 1989, D.O.U. de 23.2.1989 (Braz.).

applicants per year in Brazil,<sup>98</sup> positions in remote locations remain unattractive. Indeed, this point helped to motivate the 2010 federal environmental service strike. Demonstrators asserted that office positions have the same or better payment than those which involve serious risks.<sup>99</sup> Finally, even being an economic giant and one of the world's biggest democracies, corruption breeds distrust. According to a 2009 survey led by Transparency International, the global coalition against corruption, Brazil fell below the ideal score for perceived level of public-sector corruption.<sup>100</sup>

The need for improving management is not restricted to the context of the Brazilian environmental system. In that regard, the executive branch is working on tools "to transform the Brazilian Federal bureaucracy into a modern, results-oriented entity that effectively provides public goods and services that are demanded by

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<sup>98</sup> Civil service exams have developed a 30 billion dollar market, including, for example, preparation courses and publishers. See Ernando Pimentel, *Concurso Público – o “Boom” do Momento*, ASSOCIAÇÃO NACIONAL DE PROTEÇÃO E APOIO AO CONCURSO PÚBLICO, <http://www.anpac.org.br/portal/index.php/artigos/82-concurso-publico-o-qboomq-do-momento> (last visited Jun. 29, 2010).

<sup>99</sup> See Letter from Comando Nacional de Greve dos Servidores do MMA, Ibama, Instituto Chico Mendes e Serviço Florestal Brasileiro, to Maria do Socorro M. Gomes, Human Resources Head, Planning, Budget and Management Ministry (Jun. 2, 2010), available at <http://www.asibama.org.br/asibama/index.php?content,0,0,1145,0,0.html>.

<sup>100</sup> See International Transparency, *Corruption Perception Index 2009*, TRANSPARENCY INTERNATIONAL 1, available at [http://www.transparency.org/content/download/47599/761843/CPI+2009+Regional+Highlights+Americas\\_en.pdf](http://www.transparency.org/content/download/47599/761843/CPI+2009+Regional+Highlights+Americas_en.pdf) (last visited Jun. 29, 2010). “Among the 31 countries from the Americas included in Transparency International’s (TI) 2009 *Corruption Perceptions Index (CPI)*, 10 scored above 5 (out of 10) while 21 scored less than 5 indicating a serious corruption problem. Overall, nine countries failed to exceed a score of 3, indicating rampant corruption. With the exception of Guatemala, no country in the region showed a substantial increase in its CPI score . . . . Among the nine countries that fell below a score of 5 are Brazil, Peru, Colombia and Mexico, all leading economies in the region which should become anti-corruption strongholds but have been rocked by scandals involving impunity, kickbacks, political corruption and state capture.” *Id.*

citizens.”<sup>101</sup> While the bureaucracy is not yet effective and efficient, the government is acting in parallel, pursuing, as much as possible, the protection of the environment.

In this context, in 2009, the Ministry of the Environment (*Ministério do Meio Ambiente* – MMA) invited financial institutions to jointly commit to the “Green Protocol” (*Protocolo Verde*). Government-owned banks adhered first<sup>102</sup> and then the Brazilian Federation of Banks (*Febraban*) joined the commitment with some variances in its original wording.<sup>103</sup> Both committed on a best efforts basis.

Among many provisions of the initial document signed by government-owned banks, the one which states that the signatories should “perform the social and environmental analysis of *clients* whose activities require [an] environmental permit *and/or* represent significant adverse social impacts” is problematic.<sup>104</sup> The “and/or” provision creates a significant legal uncertainty. Notwithstanding that the Federal Constitution states that government and society share the duty to defend the environment, it also clearly expresses that the government itself has the duty to require an environmental impact assessment (EIA). Article 225 of the Federal Constitution reads:

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<sup>101</sup> WORLD BANK, *Brazil: Planning for Performance in the Federal Government*, in 1 REVIEW OF PLURIANNUAL PLANNING, at iii (2002).

<sup>102</sup> Banco Nacional de Desenvolvimento Econômico e Social (BNDES), Caixa Econômica Federal (CEF), Banco do Brasil S/A (BB), Banco da Amazônia S/A (BASA), and Banco do Nordeste (BNB)) committed to the first version of the Green Protocol. *Protocolo Verde*, BANCO NACIONAL DE DESENVOLVIMENTO ECONÔMICO E SOCIAL [hereinafter *Protocolo Verde*, *Government Owned Banks*], [http://www.bndes.gov.br/SiteBNDES/export/sites/default/bndes\\_pt/Galerias/Arquivos/empresa/download/ProtocoloVerde.pdf](http://www.bndes.gov.br/SiteBNDES/export/sites/default/bndes_pt/Galerias/Arquivos/empresa/download/ProtocoloVerde.pdf) (last visited Jan. 17, 2010).

<sup>103</sup> *Protocolo Verde*, FEDERAÇÃO BRASILEIRA DE BANCOS [hereinafter *Protocolo Verde*, *Febraban*], [http://www.febraban.org.br/p5a\\_52gt34++5cv8\\_4466+ff145afbb52ffrtg33fe36455li5411pp+e/sitefebraban/PROTOCOLO%20DE%20INTEN%C7%D5ES.PDF](http://www.febraban.org.br/p5a_52gt34++5cv8_4466+ff145afbb52ffrtg33fe36455li5411pp+e/sitefebraban/PROTOCOLO%20DE%20INTEN%C7%D5ES.PDF) (last visited Jan. 17, 2010).

<sup>104</sup> *Protocolo Verde*, *Government Owned Banks*, *supra* note 102 (emphasis added) (original wording: “Efetuar a análise socioambiental de clientes cujas atividades exijam o licenciamento ambiental e/ou que representem significativos impactos sociais adversos.”). *Id.*

In order to ensure the effectiveness of this right [to an ecologically balanced environment], it is incumbent upon the *Government* to . . . demand in the manner *prescribed by law*, for the installation of works and activities which may potentially cause significant degradation of the environment, a *prior environmental impact study*, which shall be made public . . .<sup>105</sup>

The Federal Constitution is straightforward in stating that the demand for a prior environmental study should be in accordance to the law.

Underneath the obscure terms of the "Green Protocol," government-owned banks are supposed to be the beams of the balance when pondering the constitutional values of environmental protection and economic growth, which contradicts the National Policy Act when stating that the Environmental National Council (CONAMA) will determine the cases where a beneficiary should lose or have suspended its participation in credit lines from official funding entities, such as government-owned banks. Moreover, Brazilian law only conditions official funding on the presentation of environmental permits and further compliance regulations.<sup>106</sup>

On the one hand, the option for the term "client," instead of "borrower" or "project," imposes greater exposure for financial institutions under Brazilian environmental lender liability. This commitment creates a possible nexus of causation for environmental damages that would not exist under the statutory law in force. On the other hand, by selecting such a broad concept—without defining its content—the text of the document makes the commitment weaker and vague. In the legal and financial worlds, it is hard to welcome such ambiguous terms, conditions and risks.

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<sup>105</sup> C.F. Oct. 15, 1988, art. 225 (Braz.) (emphasis added) (original wording: "§ 1º - Para assegurar a efetividade desse direito, incumbe ao Poder Público . . . IV - exigir, na forma da lei, para instalação de obra ou atividade potencialmente causadora de significativa degradação do meio ambiente, estudo prévio de impacto ambiental, a que se dará publicidade . . . "). *Id.*

<sup>106</sup> Lei No. 6938, de 31 Agosto de 1981, D.O.U. de 02.09.1981 (Braz.).

Notwithstanding the revised and more realistic terms committed by the Brazilian Federation of Banks, they also bring alarming provisions for stakeholders willing to invest capital in Brazil. For instance, this second "Green Protocol" indicates that its signatories should "apply social and environmental performance standards according to the economic sector when assessing projects with medium and high impacts."<sup>107</sup> It is a clear command-and-control provision being transferred to banks' management, since this provision appears in parallel to the governmental permitting system, which is the most appropriate opportunity to regulate private activities. In that regard, the National Environmental Policy Act specifies that CONAMA will establish performance standards that enable the rational use of environmental resources. This statute also allows states and municipalities to determine their own rules since they supplement and complete the federal regulation. As a result, only proposed actions which meet these criteria could be granted an environmental permit which would bind banks' activities. Hence, the "Green Protocol" tends to establish an unbearable and conflicting situation of lenders having to substitute themselves for the public administration also in the development of environmental parameters.

It is important to note that, following the global demand for accountability, which suggests that companies need to listen to their stakeholders and to include their interests in companies' decision making processes, lenders do have an active role in promoting sustainable development. Achievements of some standards, such as FTSE4Good and the Dow Jones Sustainability Index,<sup>108</sup> indeed demonstrate, notwithstanding that profits are the purpose of corporations, that shareholders have understood that companies need to seek other goals as well, including stakeholder benefits.<sup>109</sup>

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<sup>107</sup> *Protocolo Verde, Febraban, supra* note 103 (original wording: "aplicar padrões de desempenho socioambientais por setor produtivo para avaliação de projetos de médio e alto impactos negativos."). *Id.*

<sup>108</sup> See Mike Scott, *Certification: Respectability that Provides Investors with Peace of Mind*, FINANCIAL TIMES, Jun. 3, 2010, <http://www.ft.com/cms/s/2/6bf469c0-6ddb-11df-b5c9-00144feabdc0.html#axzz18goPra7g>.

<sup>109</sup> See Lynn A. Stout, *Why We Should Stop Teaching Dodge v. Ford?*, 3 VA. L. & BUS. REV. 163 (2008).

However, while this modern business model, on a superficial level, may be misunderstood as consistent with the demands lenders are facing in Brazil, a deeper analysis challenges this hypothesis. Brazil's emerging environmental enforcement is not simply requesting an expansive role of lenders, as suggested by a sustainability-driven trend. Instead, the ambitious goals identified in that country go beyond this so as to establish lenders as an alternative to a functioning public administration.

As a result, notwithstanding the noble environmental goals of the "Green Protocol," the current framework established by this document, combined with environmental protection centralized in legal actors, creates unpromising conditions for the country's competition for investment capital. Brazil's overall scenario that includes strict, joint and several environmental liability and a bureaucracy at best crawling to evolve into a performance-oriented structure, not only allows, but principally encourages a draconian "deep-pocket" strategy against lenders. This government inefficiency would result in another "significant slice of the *custo Brasil*, the shorthand term for the premium price of doing business in the country."<sup>110</sup> The "Green Protocol," in this context, can also work as a serious detour from the right—and necessary—path towards the improvement of governmental procedures that will be able to support the development of the country in sustainable ways.

### III. LESSONS FROM THE U.S. REGIME ON LENDER ENVIRONMENTAL LIABILITY

In the 1980's, the architecture of environmental liability in the United States also intimidated financial institutions. The Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA)<sup>111</sup> emerged under a broad effort to recover costs from

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<sup>110</sup> See Harvey Morris, *Ports: Traffic Grows at Double the Rate of Economy*, FINANCIAL TIMES, May 6, 2010, available at <http://www.ft.com/cms/s/0/c06a742a-571c-11df-aaff-00144feab49a.html#axzz18gpuAcE4>.

<sup>111</sup> Comprehensive Environmental Response, Compensation, and Liability Act, 42 U.S.C. §§ 9601-9675 (2006).



defendants who had engaged in "practices that were, in many cases, legal at the time they were used, and often encouraged, directly or indirectly, by government."<sup>112</sup>

CERCLA's retrospective imposition of liability coincides with the emerging Brazilian environmental liability scheme.<sup>113</sup> "CERCLA imposes strict, joint, and retroactive liability on a statutorily defined group of persons for the costs of cleaning up hazardous waste that has been 'released' into the environment." Additionally, "[c]ourts had interpreted liability under this provision to be 'joint and several' . . . [because] Congress did not specify [whether] the liability under CERCLA would be joint and several, [thus] it authorized courts to so find."<sup>114</sup>

In 1990, The Eleventh Circuit shocked financial institutions and secured creditors in *United States v. Fleet Factors Corp.*<sup>115</sup> The court determined that "a secured creditor may incur . . . liability, without being an operator, by participating in the financial management of a facility to a degree indicating a capacity to influence the corporation's treatment of hazardous waste."<sup>116</sup> Moreover, "[i]n order to achieve the 'overwhelming remedial' goal of CERCLA statutory scheme, ambiguous statutory terms should be construed to favor liability . . . ."<sup>117</sup>

Understanding that secured creditors can be involved in the management of their debtors' business in order to protect their

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<sup>112</sup> FABER ET AL., *supra* note 15, at 890-91.

<sup>113</sup> The resulting liability from CERCLA differs from the Brazilian scheme in some points. A first distinction is that CERCLA is limited to hazardous waste cleanup costs. Second, this statute identifies two categories of response: (i) a private part cleanup or (ii) a federally financed cleanup: "[W]here the responsible party cannot initially be found or is unable to provide cleanup measures, [then] the Fund can be used to clean up and later recover the costs from responsible party." Finally, CERCLA establishes clear categories of potentially liable parties and describes what they are liable for, whereas in Brazilian law, the broad term "polluter" is applied to indicate who can be liable for environmental damages. *See* FABER ET AL., *supra* note 15, at 892-93.

<sup>114</sup> FABER ET AL., *supra* note 15, at 891, 893.

<sup>115</sup> 901 F.2d 1550 (11th Cir. 1990). *See also* FABER ET AL., *supra* note 15, at 926.

<sup>116</sup> 901 F.2d at 1557-58.

<sup>117</sup> *Id.*

security interests, this court's decision recognized what the market had already come to appreciate as sound banking practice. Indeed, through a detailed study on large risks published in 2009, Fitch Ratings found that environmental concerns should not be overlooked or underestimated, because it is riskier to have them identified only after resources have been previously committed.<sup>118</sup> As a result, especially in the conception and implementation of an infrastructure enterprise, lenders should be aware of environmental risks and use their influence as much as possible to achieve implementation of good environmental practices to insure that their interests are being adequately protected.

In order to illustrate how the market has already learned that "projects must be realized because they are fully desirable and viable, not only because there is funding available,"<sup>119</sup> consider the frustrated first attempt to dig the Panama Canal in 1880, whose French developer underestimated environmental factors that were decisive for the complete failure of the project. Consequently, the economics of the project became unviable. In particular, the financial model was not prepared to accommodate necessary changes in the design and timetable of the project.<sup>120</sup> Recently, other giant projects have also initially underestimated environmental impact concerns, such as the European Öresund Bridge<sup>121</sup> (Denmark-Sweden) and the Vasco da

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<sup>118</sup> See NICOLAS PAINVIN, FITCH RATINGS, LARGE PROJECTS, GIANT RISKS? LESSONS LEARNED—SUEZ CANAL TO BOSTON'S BIG DIG 5 (2009), *available at* <http://www.finance-quebec.com/Fitch%20Large%20Projects,%20Giant%20Risks.pdf>. Fitch Ratings, along with Moody's and Standard & Poors, is one of the leading credit rating agencies in connection with issuances of securities.

<sup>119</sup> *Id.* at 1.

<sup>120</sup> "The Panama Canal Company was consequently liquidated. At that time, the construction had only reached about 40% (12.6 km) and already cost more than twice the total initial budget." *Id.* at 10.

<sup>121</sup> "The construction contract was signed in March 1991, before any environmental impact assessment study (EIA) was carried out . . . . Works ended in July 2000, three months ahead of schedule but with the bridge coast to coast structure 25% and the landside infrastructure 70% over budget. This cost overrun is mostly attributable to changes in design due to enhanced environmental and safety standards." *Id.* at 13-14.

Gama Bridge<sup>122</sup> (Portugal), which have incurred significant cost overruns.

The five dimensions for project finance exposure identified by the Bank of International Settlement (BIS) are: the financial strength of the project; the political and legal environment; transaction characteristics; the strength of sponsor; and the quality of the security package.<sup>123</sup> These dimensions suggest the sources of increased risk associated with postponement of environmental risk assessment and management. Environmental concerns can easily affect all these dimensions. Two of them, political and legal environment, and quality of the security package, offer particular opportunity for environmental matters to augment the risks. These are good reasons that secured lenders ordinarily have some involvement in environmental affairs of their debtors.

As a result of these attentive lending practices, U.S. courts, such as the Eleventh Circuit in *Fleet Factors*, concluded that “banks could greatly advance CERCLA’s goals.”<sup>124</sup> Based on the polluter-pays principle,<sup>125</sup> which is a principle that also directs Brazil’s environmental law, CERCLA pursues its goals by targeting those companies and persons who most profited from risky disposal practices.<sup>126</sup> Therefore, CERCLA statutorily expressed that “owners

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<sup>122</sup> “After construction had already started in February 1995, the environmental lobbyists obtained design modifications to address mitigation of wetland and bird preservation issues, traditionally highly sensitive in a river mouth area. This entailed important design variations, which could have been addressed upfront if the environmental impact studies had been conducted before.” *Id.* at 15-16.

<sup>123</sup> Bank of International Settlement, International Convergence of Capital Measurement and Capital Standards 231-237 (2005), available at <http://www.bis.org/publ/bcbis118.pdf>.

<sup>124</sup> See Roslyn Tom, *Interpreting the Meaning of Lender Management Participation Under Section 101(20)(A) of CERCLA*, 98 YALE L.J., 925, 927 (1989).

<sup>125</sup> “The core of the polluter pays principle argues that neither the government nor society-at-large should subsidize pollution and polluters and that polluters should internalize the costs of pollution abatement . . . . Finally, the principle has a pedagogical effect of encouraging individual responsibility for pollution and in general.” Jonathan R. Nash, *Too much market? Conflict between tradable pollution allowances and the “polluter pays” principle*, 24 HARV. ENVTL. L. REV. 465, 468 (2000).

<sup>126</sup> FABER ET AL., *supra* note 15, at 891.

and operators," "arrangers," and "transporters" are potentially liable parties.<sup>127</sup> Lenders, through their capacity to influence the borrowers' environmental practices could find themselves within in the "owners and operators" category.

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<sup>127</sup> FABER ET AL., *supra* note 15, at 904. Through section 107, CERCLA establishes four categories of potentially liable parties and describes what they are liable for. For the purpose of this study, current owner and operator and the former owner and operator will be considered under the same category. CERCLA section 107 reads: "Notwithstanding any other provision or rule of law, and subject only to the defenses set forth in subsection (b) of this section--(1) the owner and operator of a vessel or a facility, (2) any person who at the time of disposal of any hazardous substance owned or operated any facility at which such hazardous substances were disposed of, (3) any person who by contract, agreement, or otherwise arranged for disposal or treatment, or arranged with a transporter for transport for disposal or treatment, of hazardous substances owned or possessed by such person, by any other party or entity, at any facility or incineration vessel owned or operated by another party or entity and containing such hazardous substances, and (4) any person who accepts or accepted any hazardous substances for transport to disposal or treatment facilities, incineration vessels or sites selected by such person, from which there is a release, or a threatened release which causes the incurrence of response costs, of a hazardous substance, shall be liable for--(A) all costs of removal or remedial action incurred by the United States Government or a State or an Indian tribe not inconsistent with the national contingency plan; (B) any other necessary costs of response incurred by any other person consistent with the national contingency plan; (C) damages for injury to, destruction of, or loss of natural resources, including the reasonable costs of assessing such injury, destruction, or loss resulting from such a release; and destruction of, or loss of natural resources, including the reasonable costs of assessing such injury, destruction, or loss resulting from such a release; and (D) the costs of any health assessment or health effects study carried out under section 9604(i) of this title. The amounts recoverable in an action under this section shall include interest on the amounts recoverable under subparagraphs (A) through (D). Such interest shall accrue from the later of (i) the date payment of a specified amount is demanded in writing, or (ii) the date of the expenditure concerned. The rate of interest on the outstanding unpaid balance of the amounts recoverable under this section shall be the same rate as is specified for interest on investments of the Hazardous Substance Superfund established under subchapter A of chapter 98 of Title 26. For purposes of applying such amendments to interest under this subsection, the term "comparable maturity" shall be determined with reference to the date on which interest accruing under this subsection commences." 42 U.S.C. § 9607(a) (2006).

Hence, "the key issue in determining lender liability under CERCLA revolves around the element or degree of control attributed to the lender."<sup>128</sup> In that regard, courts failed to agree on a uniform interpretation of CERCLA's secured creditor's exemption.<sup>129</sup> This lender's safeguard results from the provision that the term "owner and operator" does not include "a person, who, without participating in the management of a vessel or facility, holds indicia of ownership primarily to protect his security interest in the vessel or facility."<sup>130</sup> In fact, two central controversies emerged from different courts' interpretation of the statute's terms: "participation in management" and "holds indicia of ownership primarily to protect his security interest." Namely, controversy arose concerning "first, whether a lender who implements a loan workout plan, or places a loan officer on a borrower's advisory board to ensure repayment of the loan, will inadvertently incur liability as an 'operator' under CERCLA; and second, whether a lender who forecloses on contaminated property when a borrower defaults on a loan will incur liability as an 'owner.'"<sup>131</sup>

In 1990, the participation-management controversy became evident.<sup>132</sup> In *In re Bergsoe Metal Corp.*<sup>133</sup> liability was not extended to the issuer of bonds which provided funds for Bergsoe Metals Corporation's recycling plant, whose facilities had been abandoned after the company filed for Chapter 11 bankruptcy. In this case, the court declared that a secured creditor would fall outside CERCLA's secured creditor's exemption only if there were some actual management of the facility. As a result, "what the lender had actually done and not what the lender was capable of doing" was the central

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<sup>128</sup> Michael I. Jeffery, *Environmental Liability: A Continuing Concern for Lenders*, in ENVIRONMENTAL REGULATION AND ECONOMIC GROWTH 49, 51 (2003).

<sup>129</sup> Cases that here illustrate that fact have been examined by different federal courts.

<sup>130</sup> 42 U.S.C. § 9601(20)(A) (2006).

<sup>131</sup> Lisa G. Dwyer, *Relief from CERCLA's 'Rock and a Hard Place': The Asset Conservation, Lender Liability and Deposit Insurance Protection Act*, 3 ENVTL. L., 862-63 (1997).

<sup>132</sup> *United States v. Fleet Factors Corp.*, 901 F.2d 1550 (11th Cir. 1990).

<sup>133</sup> *In re Bergsoe Metal Corp.*, 910 F.2d 668 (9th Cir. 1990).

point of court's assessment.<sup>134</sup> On the other hand, in *Fleet Factors*, a narrower management-participation theory of liability was adopted in such a way that an involvement "sufficiently broad to support the inference that it could affect hazardous waste disposal decisions if it chose" would trigger lender liability.<sup>135</sup> Consequently, a lender with a mere capability to make an actual decision on waste disposal would incur CERCLA's liability. The *Fleet Factors* court launched the "could affect" standard.<sup>136</sup>

Likewise, courts failed to establish a uniform interpretation of the phrase "holds indicia of ownership primarily to protect his security interest."<sup>137</sup> This second—and earlier—controversy is illustrated by different outcomes resulting from *United States v. Mirabile*<sup>138</sup> and *United States v. Maryland Bank & Trust*.<sup>139</sup> In *Mirabile*, the first case that directly addressed lender liability under CERCLA,<sup>140</sup> the defendant, a lender that foreclosed on contaminated property and then purchased the property at a foreclosure sale, was not found liable because the court understood that the creditor's acts were undertaken to protect its security interest, and as a result, the exemption should be applied.<sup>141</sup> In this direction, the "court ignored the lender's actual ownership of the property and instead made a judgment based solely on what it believed motivated the lender's actions."<sup>142</sup> Conversely, in *Maryland Bank & Trust*, a case with facts similar to those found in *Mirabile*, another federal court held that the security interest exemption would not protect the lender that

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<sup>134</sup> Joanne S. Liu, *Lender Liability Protection in the Aftermath of CERCLA's Security Interest Exemption Crisis: Treating Lenders Like Lender*, 17 ANN. REV. BANKING L. 575, 589 (1998).

<sup>135</sup> *United States v. Fleet Factors Corp.*, 901 F.2d 1550, 1557-1158 (11th Cir. 1990).

<sup>136</sup> See *Bancamerica Commercial Corp. v. Trinitz Industries, Inc.*, 900 F. Supp. 1427 (D. Kan. 1995).

<sup>137</sup> Dwyer, *supra* note 131, at 864.

<sup>138</sup> No. 84-2280, 1985 WL 97 (E.D. Pa. Sept. 4, 1985)

<sup>139</sup> 632 F. Supp. 573 (D. Md. 1986).

<sup>140</sup> Liu, *supra* note 134, at 582.

<sup>141</sup> Dwyer, *supra* note 131, at 864.

<sup>142</sup> Liu, *supra* note 134, at 583.

foreclosed and acquired a secured property.<sup>143</sup> Hence, the court held that as the mortgagee became an owner of the property, the security exemption was lost.<sup>144</sup>

Notwithstanding, courts have not established a uniform definition for secured creditor exemption's decisive phrases; courts had a tendency to interpret them narrowly.<sup>145</sup> The clamor of the banking community and the fact that federal government was increasing its role as a secured creditor, in connection with its interventions in the banking system, pressed the Environmental Protection Agency (EPA). Accordingly, in 1992, the EPA issued a regulation clarifying lender liability under CERCLA.<sup>146</sup> The EPA's rule explicitly defined (i) "indicia of ownership," (ii) "participation in management," and (iii) "primarily as security interest."<sup>147</sup> In 1994, however, in *Kelley v. EPA*,<sup>148</sup> the rule was vacated on the ground that the EPA lacked authority to issue rules interpreting the secured creditor exemption as a binding regulation.<sup>149</sup> According to the holding, Congress "designated the courts and not the EPA as adjudicator of the scope of CERCLA liability."<sup>150</sup>

Then, in 1996, Congress amended the statute's lender liability provisions to more firmly entrench the EPA regulatory framework. Essentially, the new rule—Asset Conservation, Lender Liability and Deposit Insurance Protection Act<sup>151</sup>—determines that secured creditors can be considered an "owner or operator" only if they

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<sup>143</sup> *Id.* at 583.

<sup>144</sup> Dwyer, *supra* note 131, at 864 (quoting *Maryland Bank & Trust*, 632 F. Supp. at 580).

<sup>145</sup> *Id.*

<sup>146</sup> Lender Liability Under CERCLA, 57 Fed. Reg. 18,344, 18,382 (Apr. 29, 1992) (codified as amended at 40 C.F.R. §300.1100).

<sup>147</sup> Dwyer, *supra* note 131, at 865.

<sup>148</sup> *Kelley v. EPA*, 25 F.3d 1088 (D.C. Cir. 1994).

<sup>149</sup> Memorandum from Barry Breen, EPA Director Office of Site Remediation Enforcement, to Regional Counsels et al. (June 30, 1997), *available at* <http://www.epa.gov/compliance/resources/policies/cleanup/superfund/lendr-aquis-mem.pdf>.

<sup>150</sup> Liu, *supra* note 134, at 592 (quoting *Kelley v. EPA*, 15 F.3d at 1107-08).

<sup>151</sup> Pub. L. No. 104-208, §§ 2501-2505, 110 Stat. at 3009-462 to 469 (1996) (codified at 42 U.S.C. §§ 9601(n), 9607(n), 6991b(h)(9)).

actually participate in the management or operational affairs of a facility, and not merely if they have the capacity to influence, or the unexercised right to control, facilities operations.<sup>152</sup> In subsequent cases, such as *Monarch Tile, Inc. v. City of Florence*,<sup>153</sup> courts have held that the “terms ‘owner’ and ‘operator’ do not have any special meaning under CERCLA, but are to be given their ‘ordinary meanings.’”<sup>154</sup> This understanding negates the *Fleet Factors* management theory. Additionally, differing from the *Mirabile* holding, it also recognizes a different dynamic usually identified through lender’s ownership of the contaminated property, where the bifurcation between “obtaining,” but not “retaining” the property for further economic developments suggests that the lender would qualify for secured creditor exemption.<sup>155</sup> As long as a lender “holds indicia of ownership primarily to protect” its security interest in the property, it is expected that its efforts to divest the property are taken at the “earliest, practicable, commercially reasonable time.”<sup>156</sup>

Notwithstanding the presumption of non-liability for lenders,<sup>157</sup> creditors have the burden of establishing their entitlement to CERCLA’s exemption.<sup>158</sup> However, “[d]espite the safe harbor exemption, lenders still face potential liability in foreclosure situations. Activities such as hiring guards to protect abandoned property . . . may generate liability as an operator.”<sup>159</sup>

Comparing U.S. and Brazil’s lender environmental liability scheme, it is evident that the American scope is substantially narrower than the Brazilian one. The U.S. model, however, does not eliminate environmental concerns. Instead, it brings lender’s exposure in line with other risks, making their liability limited and

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<sup>152</sup> FABER ET AL., *supra* note 15, at 926.

<sup>153</sup> 212 F.3d 1219 (11th Cir. 2000).

<sup>154</sup> *Id.* at 1222.

<sup>155</sup> *Id.* at 1223-24.

<sup>156</sup> Liu, *supra* note 134, at 599 (quoting Olaf de Senerpont Domis, *New Law Finally Limits Environmental Liability*, AM. BANKER, Oct. 2, 1996, at 3).

<sup>157</sup> See Liu, *supra* note 134, at 599.

<sup>158</sup> *Monarch Tile*, 212 F.3d at 1222.

<sup>159</sup> A. BARRY CAPPELLO, LENDER LIABILITY 325 (2009).



predictable, not open-ended.<sup>160</sup> As long as lenders are treated like lenders—and not owners—when applying sound banking practices, this model seeks to avoid lenders' reluctance to grant financial support or loans, which would be important resources to fund, for example, cleanup actions. Additionally, the gradual development of the U.S. threshold to lender liability occurred in a direction totally opposite to that of the trend now observed in Brazil, where the public administration, through the "Green Protocol," makes the boundaries between the roles of government and financial institutions even more ambiguous.

#### IV. MULTILATERAL DEVELOPMENT BANKS, EXPORT CREDIT AGENCIES AND EQUATOR PRINCIPLES FINANCIAL INSTITUTIONS

If not well addressed when doing business in Brazil, the positive environmental commitments of Multilateral Development Banks (MDB), Export Credit Agencies (ECA) and commercial banks signatories of the Equator Principles (EPFI) can now result in establishing lender liability under Brazil's domestic environmental law, notwithstanding their care to refrain from actually participating in the management or operation of the project.

Just like the rationale that inspired the U.S. lender liability, MDBs, ECAs, and EPFIs are willing to protect their interests—including reputational concerns—through the adoption of environmental considerations in their lending procedures. Additionally, MDBs have a broader development mandate, and EPFI's are inspired by the emerging sustainability-driven business model. Nonetheless, NGOs maintain that there is a "culture of loan approval," and that environmental issues are being overlooked by some of these lenders.<sup>161</sup>

Successful campaigns of environmental groups on lending policies have already triggered substantial changes in how the

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<sup>160</sup> Liu, *supra* note 134, at 600.

<sup>161</sup> Lisa Friedman, *South African Coal Plant Proposal Strains 'Culture' of World Bank*, N.Y. TIMES, Apr. 5, 2010, <http://www.nytimes.com/cwire/2010/04/05/05climatewire-south-african-coal-plant-proposal-strains-cu-41781.html>.

world's largest development institutions proceed.<sup>162</sup> A domino effect made these concerns reach ECAs and commercial banks.

Reacting to this advocacy network, in 1989 the United States Congress adopted the so-called Pelosi Amendment, signed into law by President George H. W. Bush.<sup>163</sup> The amendment provides that U.S. representatives of each multilateral development bank should not approve projects with potentially significant environmental impact without an analysis of the project's environmental and social matters for at least four months, and that a comprehensive summary be made available to affected groups and local NGOs.<sup>164</sup>

Other American agencies, namely the Overseas Private Investment Corporation (OPIC)<sup>165</sup> and the Export-Import Bank of the United States (Ex-Im),<sup>166</sup> are also incontestably involved in the development process.<sup>167</sup> As U.S. federal agencies, they are subject to the provisions of the U.S. National Environmental Policy Act (NEPA),<sup>168</sup> which requires the development of an environmental

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<sup>162</sup> NGO's complaints often arise from the promotion of unsustainable use of natural resources and obstructions to local community participation. See Ian A. Bowles & Cyril F. Kormos, *Environmental Reform at the World Bank: the role of the US Congress*, 35 VA. J. INT'L L., 777 (1995).

<sup>163</sup> 22 U.S.C. § 262m-7 (2006).

<sup>164</sup> *Id.* The 1989 version of the Pelosi Amendment also used to demand a consultation with the Secretary of State and the administrators of the U.S. Agency for International Development (USAID) and the Environmental Protection Agency (EPA). 22 U.S.C. § 262m-7 (1989) (amended 2004).

<sup>165</sup> "OPIC helps U.S. businesses invest overseas, fosters economic development in new and emerging markets, complements the private sector in managing risks associated with foreign direct investment, and supports U.S. foreign policy." OVERSEAS PRIVATE INVESTMENT CORPORATION, <http://www.opic.gov/about-us> (last visited Apr. 16, 2010).

<sup>166</sup> "Ex-Im Bank's mission is to assist in financing the export of U.S. goods and services to international markets . . . Ex-Im Bank provides working capital guarantees (pre-export financing); export credit insurance; and loan guarantees and direct loans (buyer financing)." EXPORT-IMPORT BANK OF THE UNITED STATES, <http://www.exim.gov/about> (last visited Apr. 16, 2010).

<sup>167</sup> Although Ex-Im is the U.S. official ECA, OPIC carries similar features to those of an export credit agency.

<sup>168</sup> 42 U.S.C. § 4332 (2006); See *Friends of the Earth Inc. v. Mosbacher*, 488 F. Supp.2d 889 (2007).

impact statement (EIS) for major federal actions significantly affecting the human environment.<sup>169</sup> As required by this statute, OPIC and Ex-Im have articulated their procedures to implement NEPA. These articulations are found in, respectively, the OPIC Environmental Handbook (OPIC Handbook) and Ex-Im's Environmental Procedures and Guidelines (Ex-Im Guidelines).<sup>170</sup> Both policies contemplate an environmental screening process as a necessary condition for funding access in case of project finance and long-term loans and guarantees.

The growing visibility of environmental issues within MDBs combined with the advantages of joining in a "B Loan" Syndication has reached lending operations of commercial banks. Lending practices of the International Finance Corporation (IFC), the private sector lending arm of the World Bank Group, illustrate this point. IFC provides loan and equity capital for projects that fulfill its mission "to promote sustainable private sector investment in developing countries, helping to reduce poverty and improve people's lives."<sup>171</sup> In order to also improve capacity of financial markets in developing countries,<sup>172</sup> domestic financial institutions are encouraged to be part of deals supported by IFC. However, these bank syndications are not exclusive to financial institutions from the host country. As a result, "IFC is never the sole investor in a project and always makes sure of

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<sup>169</sup> 42 U.S.C. § 4332.

<sup>170</sup> For example, in case of climate change impacts, projects developed in other countries should be subjected to NEPA because of their effects in the U.S. environment. "Ex-Im and OPIC [Defendants] argue that this Court must grant judgment in their favor because Plaintiffs improperly seek to apply NEPA to projects that are located in foreign countries. Plaintiffs, however, make clear that they seek to apply NEPA because the projects that Defendants support purportedly significantly affect the *domestic* environment. . . . [N]otwithstanding Defendants' arguments regarding foreign policy relations, there is evidence to suggest that the Defendants may have control over the manner in which these projects operate. . . . The Court DENIES Defendants' motions to the extent they are premised on the extraterritoriality argument." *Mosbacher*, 488 F. Supp. 2d at 908-909.

<sup>171</sup> *IFC Mission Statement*, INTERNATIONAL FINANCE CORPORATION, <http://www.ifc.org/ifcext/about.nsf/7afae2a79a656e70ca25692100069831/d0e9906f064f418185256d03006fcfaa?OpenDocument> (last visited Jul. 5, 2010).

<sup>172</sup> See Atiyah Curmally et al., World Resources Institute, Multilateral Development Bank Lending Through Financial Intermediaries: Environmental and Social Challenges 5 (June 2005), available at [http://pdf.wri.org/iffe\\_mdb\\_lending.pdf](http://pdf.wri.org/iffe_mdb_lending.pdf).

other private investors' participation."<sup>173</sup> The combination of A and B Loans is the most common way for IFC to participate in a project.<sup>174</sup> For example, "[w]hen an IFC loan includes financing from the market through the B Loan, IFC retains a portion of the loan for its own account (the "A Loan"), and sells participations in the remaining portion to participants (the "B Loan")." Among other advantages, a commercial bank can gain from "B Loans" because this structure results in benefits, such as the exemption from withholding taxes and the introduction of new banking relationships.<sup>175</sup> Furthermore, since the involvement of IFC in a project works like an approval seal for the deal, it makes other potential investors interested in the project.

IFC has historically been a major source of funding for Brazil. For example, in 2002, Brazil was the largest recipient of IFC financing, not only in Latin America but also globally.<sup>176</sup> However, IFC is not the only crucial MDB player in the country.<sup>177</sup> The Inter-American Development Bank Group (IDB Group),<sup>178</sup> the oldest and largest regional multilateral development bank,<sup>179</sup> also holds a significant

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<sup>173</sup> See Sahar Sotoodehnia, *Project Financing: the Role of International Finance Corporation 5* (2010) (on file with author). "For this reason, IFC's amount of investment cannot be more than 15 to 25% of the equity capital of the company and IFC usually limits its A-Loans to 25% of the total estimated project costs in a project, or 35% in small projects." Additionally, "[i]n the case of expansion projects, IFC may provide up to 50% of the project costs, on the condition that its investments do not exceed 25% of the total capitalization of the project company." *Id.*

<sup>174</sup> *Id.*

<sup>175</sup> *Id.* at 1.

<sup>176</sup> Press Release, International Finance Corporation, IFC Supports Major Footwear Producer in Brazil with \$30 Million (Nov. 12, 2002), *available at* <http://www.ifc.org/ifcext/pressroom/ifcpressroom.nsf/PressRelease?openform&12396FC5BF7B1FB185256C710075AE46> (last visited, Mar. 14, 2010).

<sup>177</sup> As of June 2009, IFC has \$6,951,978.9 million in cumulative gross commitments to enterprises in Brazil. INTERNATIONAL FINANCE CORPORATION, IFC ANNUAL REPORT 2009, at 104 (2009), *available at* [http://www.ifc.org/ifcext/annualreport.nsf/AttachmentsByTitle/AR2009\\_Volume2/\\$FILE/AR2009\\_Volume2.pdf](http://www.ifc.org/ifcext/annualreport.nsf/AttachmentsByTitle/AR2009_Volume2/$FILE/AR2009_Volume2.pdf).

<sup>178</sup> The IDB Group is composed of the Inter-American Development Bank (IDB), the Inter-American Investment Corporation (IIC), and the Multilateral Investment Fund (MIF).

<sup>179</sup> INTER-AMERICAN DEVELOPMENT BANK GROUP, ANNUAL REPORT 2009, at 4 (2009), *available at* [http://www.iadb.org/ar/2009/docs/ENG\\_AR\\_FINAL.pdf](http://www.iadb.org/ar/2009/docs/ENG_AR_FINAL.pdf).

active portfolio which, from 1961 to 2009, reached \$108 billion in cumulative lending disbursements for projects hosted by Brazil, positioning Brazil as IDB Group's largest shareholder.<sup>180</sup> Like the IFC, the IDB Group's financing also includes commercial banks as key instruments in the achievement of its development goals.

Because these commercial banks work with credit lines provided by MDBs, they are requested to consider the same social and environmental standards applied by the institution that is the source of the funding.

However, the involvement of commercial banks with environmental issues has gone beyond "B Loan" requirements. It occurred not only in response to constant environmental demands of NGOs, but also because of inherent environmental risks that become credit risks, investor demands and corporate social responsibility commitments.<sup>181</sup> Leading commercial banks have concluded that an advance environmental assessment and a subsequent monitoring program could avoid significant losses.

As a result, in 2003, the Equator Principles—"a set of guidelines developed by the banks for managing social and environmental issues related to the financing of development projects"—were launched by ten leading commercial banks.<sup>182</sup> In 2006, a revised version of the "Principles" was announced based upon the social and environmental guidelines developed by the IFC and the World Bank.

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<sup>180</sup> In the same period, Argentina and Mexico have, respectively, received \$54 and \$57 billions. *Id.* at 45.

<sup>181</sup> "The leaders have moved from the fear of reputation, to effective integrated risk management, to a proactive strategy that captures value by seeking out well performing companies, to competing on how one financial institution can invest in the best company because it understands their risks as well as their opportunities better than any other institution." Rachel Kyte, *Balancing Rights with Responsibilities: Looking for the Global Drivers of Materiality in Corporate Social Responsibility & the Voluntary Initiatives that Develop and Support Them*, 23 AM. U. INT'L L. REV. 565 (2008).

<sup>182</sup> The ten pioneer banks in the Equator Principles' Network "are ABN AMRO Bank, Barclays plc, Citigroup, Inc., Credit Lyonnais, Credit Suisse First Boston, HVB Group, Rabobank Group, The Royal Bank of Scotland, WestLB AG, and Westpac Banking Corporation." *Leading Banks Announce Adoption of Equator Principles*, THE EQUATOR PRINCIPLES (June 4, 2003), <http://www.equator-principles.com/pr030604.shtml>.

The "Principles" have been estimated to be applied voluntarily to "cover nearly 90 percent of global, cross-border project finance."<sup>183</sup> In June 2010, almost 70 leading financial institutions have committed to apply them.<sup>184</sup>

Under a superficial analysis, MDBs, ECAs and EPFIs appear more exposed to lender environmental liability under Brazilian law. Upon more thorough examination, they are better prepared to deal with the upcoming challenges, mainly because their environmental practices usually follow a regular lending cycle, organized in three stages: due diligence, loan negotiation and documentation, and portfolio management.<sup>185</sup> Hence, especially when operating in Brazil, these institutions are well-advised to fully and diligently apply their policies on environmental considerations.

How their environmental practices are reflected in the loan documentation is now decisive to protect their lending in Brazil. The terms of contracts are the best source to indicate whether their practices exacerbate or minimize the risks of environmental liability. Given the position of Brazil's Superior Court of Justice that "awareness"<sup>186</sup> of the environmental harm triggers bank liability,<sup>187</sup> a financial institution lending in Brazil has a vital interest to design contractual provisions that afford it effective tools to guarantee the flow of information and feasible mechanisms to suspend disbursements, or even, in very extreme cases, withdraw from the deal. If

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<sup>183</sup> INTERNATIONAL FINANCE CORPORATION, AN INTEGRATED REPORT 20 (2007), available at [http://www.ifc.org/ifcext/annualreport.nsf/AttachmentsByTitle/AR2007\\_English/\\$FILE/AR2007\\_English.pdf](http://www.ifc.org/ifcext/annualreport.nsf/AttachmentsByTitle/AR2007_English/$FILE/AR2007_English.pdf).

<sup>184</sup> See THE EQUATOR PRINCIPLES, <http://www.equator-principles.com> (last visited June 11, 2010).

<sup>185</sup> Motoko Aizawa, *The Equator Principles in Action: Creating a Community of Learning*, 42 INFRASTRUCTURE JOURNAL 10, 11 (2007).

<sup>186</sup> In addition, the element "awareness" is being substantially explored by powerful NGOs which jointly formed a global network that spread information about how financial institutions are operating in controversial deals, especially in developing countries, such as Brazil. See BankTrack HOME PAGE, [www.banktrack.org](http://www.banktrack.org) (last visited Apr. 19, 2010).

<sup>187</sup> S.T.J.-T2, REsp 650728, Relator: Min. Benjamin Herman, 23.10.2007, R.S.T.J., 02.12.2009 (Braz.).

these mechanisms are not well developed, the lender may try to avoid an environmental liability, but risk being sued for breach of contract.

Although the most suitable contractual clauses should be designed on a case by case basis and as a result of advance environmental analysis, lenders should strongly consider the inclusion of environmental concerns at least in key components of a loan agreement, namely the definitions section, representation and warranties,<sup>188</sup> conditions precedent,<sup>189</sup> covenants<sup>190</sup> and events of default.<sup>191</sup>

Notwithstanding constant critiques presented by NGOs, usually MDBs, ECAs and leading EPFIs are better equipped than other lenders that have not yet internalized environmental practices

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<sup>188</sup> “Representation and Warranties—a series of statements of fact made by one party on the basis of which the other party undertakes to enter into the agreement. The representations will typically cover such matters as the legality and enforceability of documentation, the compliance with relevant environmental and social laws, the financial condition of the Borrower, and the absence of any material litigation or other proceedings against the Borrower. Material inaccuracies in Borrower representations will normally constitute an Event of Default under the loan agreement.” *Guidance to EPFIs on Incorporating Environmental and Social Considerations into Loan Documentation*, THE EQUATOR PRINCIPLES (2009), <http://www.equator-principles.com/documents/EPLoanDocumentGuidance.pdf>.

<sup>189</sup> “Conditions Precedent—a set of pre-conditions that must be satisfied before the borrower can request drawdown, or before other credit facilities can be made available under a loan agreement. Conditions Precedent can be used to require borrowers to make certain progress on environmental and social issues before disbursement.” *Id.*

<sup>190</sup> “Covenants—the promises made by the Borrower to undertake certain actions (positive covenant) or to refrain from taking certain actions (negative covenant). Compliance with environmental and social laws and regulations, and the project’s Environmental and Social Action Plan, is a key covenant of project finance agreements. Reporting requirements should also be included as a covenant. Material non compliances with the covenants will normally constitute an Event of Default under the loan agreement.” *Id.*

<sup>191</sup> “Event of Default—an event that entitles the Lenders to cancel a commitment, declare all amounts owed by the Borrower to become immediately due and payable, and/or enforce security. For projects with complex environmental or social issues, the Lenders and Borrower may want to include specific environmental or social Events of Default that may for instance refer to specific remedy periods.” *Id.*

in a manner that can affect the entire lending cycle. First, they can better identify scenarios in which it is preferable to refuse to grant the loan due to environmental problems. Second, their analysts are better prepared to measure the risks of controversial deals and consider these critical issues in negotiations with the borrower. Third, investment agreements will probably reflect this diligence and provide safeguard mechanisms in case the lender is called to assume environmental damages. Especially in long-term deals, the terms of the contract can make a huge difference in courts.

For that reason, when doing business in Brazil, lenders which are not yet prepared to effectively relate environmental concerns with their analyses and investment documentation are encouraged to be associated with MDBs, ECAs and leading EPFIs. Banking syndications are the best alternative in the short-term. Indeed, commercial banks which have leading environmental practices are not only the most proper players to act as leaders of bank syndications but may also increase their leadership fees. However, it does not mean that co-lenders should expect that the internal environmental due diligence should be shared between creditors. Like other credit analysis, each financial institution protects its own expertise, especially when applied in an actual case.

Additionally, the desired "seal of approval" that involvement of some institutions, particularly MDBs, may place on a project should be balanced with the fact that some arrangements between MDBs and financial intermediaries, such as in cases where funds are disbursed directly into financial intermediaries balance sheets, may not have the same environmental effects as direct lending (e.g. in the A and B loan structure). In these indirect deals,<sup>192</sup> where the actual beneficiaries are usually not identified when the financial intermediary's project is evaluated, MDBs cannot conduct as detailed an environmental assessment as they do with direct operations. As a

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<sup>192</sup> According to a 2005 study conducted by the think tank World Resources Institute (WRI) on MDB's practices, there are six common products for indirect lending: bank loan (credit line); trade finance facility; equity investment in a private equity fund; equity investment in a local bank; donor-supported investment facility; and leasing facility. Curmally, *supra* note 172, at 4.



result, the responsibility to undertake an environmental analysis is in the financial intermediary's hands.<sup>193</sup> However, notwithstanding the supervision of the MDB,<sup>194</sup> a financial intermediary's capacity to conduct environmental due diligence and associate it to the entire lending cycle may vary substantially. In contrast, this delegation of environmental analysis and monitoring process to financial intermediaries may undermine the effects of a full application of MDB's environmental standards, particularly because "MDB's baseline performance standards is that [financial intermediaries'] subprojects must follow the host country's regulations, despite the risk of overrelying on these regulations in regard to implementation and enforcement."<sup>195</sup>

## V. CONCLUSION

The emerging doctrine on strict, joint and several environmental lender liability, combined with broad standing that welcomes not only the Public Ministry, but also non-governmental organizations, is alarming to lenders that operate in Brazil. The emerging doctrine portrays lenders as the best target to pursue environmental goals in the country. Due to chronic problems in the bureaucracy of the public administration, the Brazilian government marches in the opposite direction of U.S. leaders. Through the "Green Protocol," the government seeks to deepen banking involvement in environmental issues, which may represent a serious detour from the imperative of improving the functionality of the public administration. As a result, although lenders and legal actors, such as the Public Ministry and NGOs, and particularly lenders with a broader development mandate, are significant contributors towards sustainable development, their substitution for the public administration likely does not achieve the necessary environmental protection in the long-run.

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<sup>193</sup> *Id.* at 5-6.

<sup>194</sup> "[W]ith the exception of the MDB's monitoring of certain category A [the most risky] subprojects, an annual report from the FI project sponsor to the MDB is often the only check with regard to the subprojects' compliance with the MDB's environmental and social standards over the life of an FI project." *Id.* at 7.

<sup>195</sup> *Id.* at 8.

Even though secured creditors in the U.S. have also faced a similar situation upon the initial adoption of CERCLA, developments supported by the Federal Environmental Protection Agency led to a safer scenario. The American doctrine on lender liability was tailored to sound banking practices. Today, it is clear that a lender's routine actions to limit its exposure to losses resulting from a borrowers' failure to maintain sound environmental practices have a low risk of resulting in lender liability.

Brazil now faces the risk of suffering a significant downturn in the global competition for investment capital. However, practices of MDBs, ECAs and leading EPFIs, if fully and diligently applied, can protect banks from environmental liability. A lender not yet prepared to internalize environmental concerns throughout its lending cycle can benefit from banking syndication with an institution capable of dealing with these risks. Strong credit analysis and appropriate loan documentation are even more crucial in upcoming deals in Brazil.

