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# Brazil Energy Journal

FOREIGN CURRENCIES INDEXED PPAS



# Overview

The power trading transactions among generators, traders, utilities and customers in Brazil take place in the Regulated Contracting Environment (ACR) and the Free Contracting Environment (ACL). The Power Purchase Agreements (PPAs) in the ACR and ACL are denominated in Brazilian reais, except in certain cases as permitted by applicable laws.

In the ACR, the PPAs follow a standard form under a public tender process (energy auction) carried out by the National Electric Energy Agency (ANEEL). The winners of the energy auction are required to execute the PPA "as is," and there is no room for negotiation of its terms and conditions. The offtakers are the utilities or the Chamber of Electric Energy Commercialization (CCEE) and, ultimately, the captive customers. As a general rule, the PPAs in the ACR are denominated in Brazilian reais as they do not fit under any exception for foreign currency denomination as per applicable laws. The only ACR PPA that admits a partial and limited foreign currency indexation is the PPA destined for thermoelectric plants fueled by imported natural gas, where the cost of the imported fuel may be adjusted by certain international natural gas indexes set in US dollars and US dollar exchange rate variation.

In the ACL, PPAs are freely negotiated bilateral contracts, and, thus, parties may agree to denominate the price in US dollars in the cases permitted by applicable laws. The legality of the indexation to foreign currency of PPAs in certain cases has been reinforced by a recent change in law. Following the expansion of the ACL, an increase in the demand for PPAs indexed in foreign currencies—including Corporate PPAs—is expected.

Indexing the price of the PPA to a foreign currency might be advantageous for the parties for a number of reasons, such as:

01

Establishing that the project's revenue will be in the functional currency of the developer and/or the offtaker

02

Reducing the parties' exposure to exchange rate fluctuations

03

Offering easier access to international project finance structures

Indeed, the Brazilian legal framework adopts the rule of legal tender of the Brazilian real for all transactions that are enforceable in Brazil, except in certain cases expressly permitted by law. Accordingly, case law based on rulings by the Superior Court of Justice (STJ) that agreements illegally indexed to foreign currencies must have their prices converted into BRL based on the exchange rate of the date of execution of the agreement. Thus, it is pivotal to understand the exceptions provided by law where PPAs may be indexed to foreign currency.

The rule of legal tender of the national currency was initially foreseen in the Brazilian Civil Code of 1916 and Decree No. 23,501, dated of November 27, 1933. The exceptions to such a rule were provided for in five items of article 2° of Decree-Law No. 857, dated of September 11, 1969, which permitted foreign currency indexation in the following cases:

01

Agreements and titles related to import or export of goods

02

Loan agreements or guarantee agreements related to export transactions of goods or services

03

Foreign exchange transactions

04

Loan agreements executed by lenders/borrowers resident abroad

05

Agreements related to the assignment, transfer or assumption of obligations referred to in the item above, even if all parties involved are domiciled or resident in Brazil

In the years that followed, a set of laws ratifying this general provision and exceptions was edited in the context of the Plano Real and the monetary policies against high inflation rates, such as (i) Law No. 8,880, dated May 27, 1994; (ii) Law No. 9,069, dated June 29, 1995; (iii) Law No. 10,192, dated February 14, 2001; and (iv) the Brazilian Civil Code of 2002.

As further detailed below, PPAs have been indexed to foreign currency based on exceptions described in article 2°, items I, IV and V of Decree-Law No. 857/1969, also replicated in Law No. 8,880/1994. Decree-Law No. 857/1969 and article 6° of Law No. 8,880/1994 were revoked by Law No. 14,286, dated as of December 29, 2021 (Foreign Exchange Law), which came into effect on December 30, 2022. The Foreign Exchange Law expanded the exceptions mentioned above in items I to IX of its article 13, which are worded as follows:

**01**

Agreements related to the foreign trade of goods and services and their financing and guarantees

**02**

Obligations in which the lender or the borrower is resident and domiciled abroad, including those arising from credit of leasing operations, except lease agreements of real estate located in Brazil

**03**

Leasing agreements entered into between residents in Brazil, based on funds raised abroad

**04**

Assignment, transfer, delegation, assumption or modification of the obligations mentioned in items I, II and III above even if both contracting parties are residents or domiciled in Brazil

**05**

In the purchase and sale of foreign currency

**06**

In the indirect exportation referred to in Law No. 9,529, dated December 10, 1997

**07**

Agreements entered into between exporters and holders of concessions, permissions, authorizations or lessees in infrastructure sectors

**08**

In situations foreseen in the regulation issued by the National Monetary Council, when the foreign currency indexation can mitigate the exchange risk or increase the efficiency of the business

**09**

In other situations foreseen in the legal framework

As provided in article 13, item VIII of the Foreign Exchange Law, the National Monetary Council (CNM) has the authority to expand these exceptions. Note that the Foreign Exchange Law is subject to regulation by the Brazilian Central Bank (BACEN), which has, to this day, enacted at least five Normative Resolutions on the matter. However, none of these Resolutions has affected in any way the exceptions to the legal tender of the Brazilian real provided for in article 13 of the Law.

On the next page is a brief summary of the main cases where PPAs may be indexed to foreign currency in Brazil.

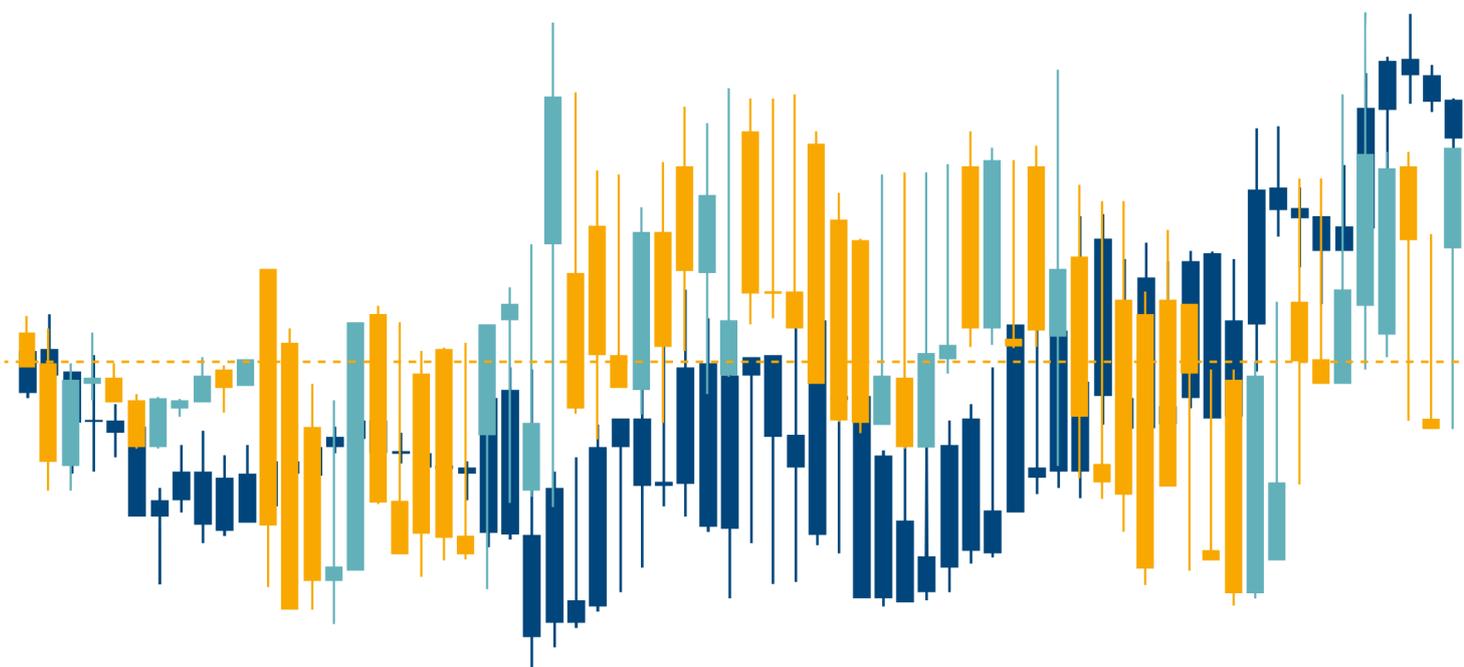
# PPA foreign currency indexation when the offtaker is an exporter

As mentioned before, the exceptions to legal tender of the Brazilian real provided in Decree-Law No. 857/1969 allowed foreign currency indexed PPAs to take place in Brazil even before the enactment of the Foreign Exchange Law. Based on an interpretation of article 2º, item I of Decree-Law No. 857/1969, parties would use foreign currency indexation in PPAs where the offtaker was an exporter of goods or services.

Accordingly, article 13, item VII of the Foreign Exchange Law expressly authorizes the contractual parties to stipulate the foreign currency indexation in agreements entered into between exporters and holders of concessions, permissions, authorizations or lessees in infrastructure sectors.

Brazilian customs legislation, pursuant to the article 2, item III of the Normative Instruction of the Federal Revenue of Brazil No. 1,702/2017, defines an exporter as any person who promotes the exit of goods from the national territory. On the other hand, power generation and power trading companies, as holders of concessions or authorizations issued by ANEEL, fall into the definition of holders of concessions and authorizations in an infrastructure sector.

Thus, the Foreign Exchange Law stops any potential challenge related to the interpretation of article 2º, item I of Decree-Law No. 857/1969, as it expressly addresses the PPAs entered into between exporters and power companies.

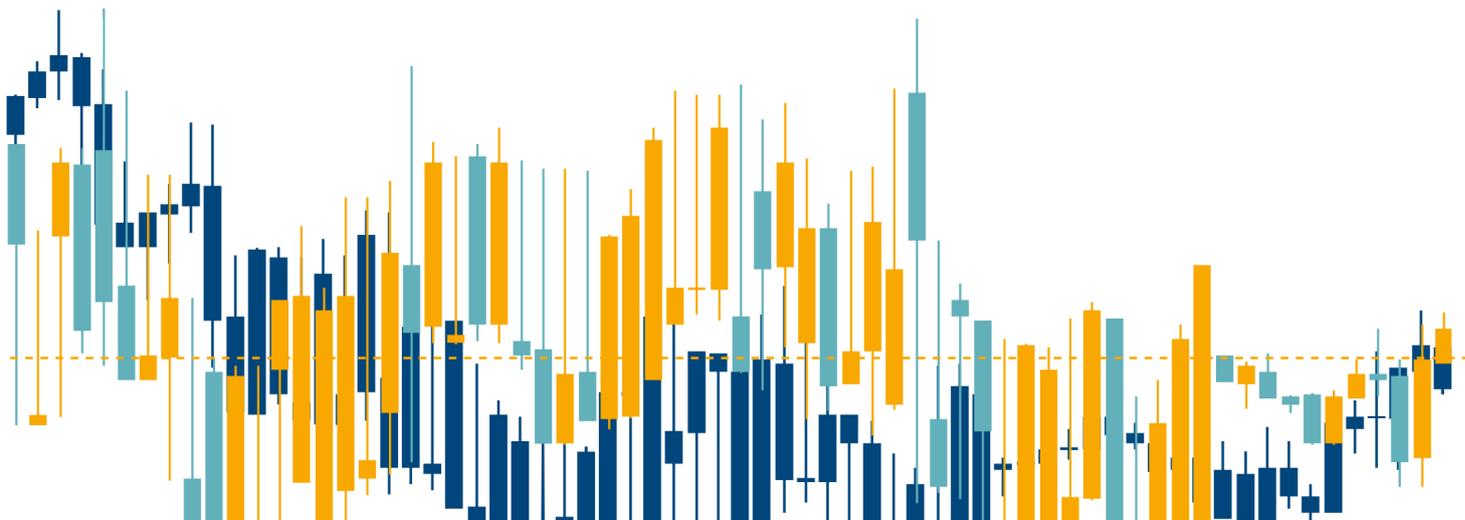


# PPA foreign currency indexation in connection with a foreign currency project finance structure

Another structure that allows foreign currency indexation of a PPA is based on a foreign currency financing by a foreign lender that supports the implementation of the power generation project that will generate the power contracted under the PPA. Said structure was originally provided for on the items IV and V of article 2 of Decree-Law No. 857/1969, but is now provided for in items I to IV of the article 13 of the Foreign Exchange Law.

Under this context, the PPA is construed as an ancillary agreement to an international project financing structure, where the project owner obtains funding in foreign currency for the construction of the power generation project and the receivables in the same foreign currency under the PPA are assigned to the lender as collateral to the loan. In other words, in this scenario, the PPA falls under the definition of an agreement that provides "for the assignment, transfer, delegation, assumption or modification of obligations" related to an international project financing in foreign currency.

The legality of the foreign currency indexation of the PPA is reinforced when there are also other elements related to the underlying power generation project that are linked to foreign currency, such as when (i) the project has relevant capex exposure to foreign currency (e.g., when the project will be implemented with imported equipment); (ii) the project owner is controlled by a foreign entity who (ii.i) also provides funding in foreign currency for the construction of the project, or (ii.ii) acts as guarantor under the PPA and/or the financing agreement; or (iii) the offtaker is controlled by a foreign entity who acts as guarantor under the PPA and/or the financing agreement.



# Mitigating the risk of challenge to the PPA foreign currency indexation

There are also contractual mechanisms to mitigate the risk that a party challenges the legality of the foreign currency indexation of the PPA, which could occur, for instance, in the event of an unexpected exchange rate variation that results in an unexpected burden to such a party.

## Context and rules of interpretation in the PPA

It is relevant to expressly explain the rationale of the parties regarding the indexation to the foreign currency in the PPA and the legal grounds for such foreign currency indexation. In addition, in the interpretation rules of the PPA, we also recommend parties to waive the provision under article 113, § 1º, item IV of the Brazilian Civil Code, as amended by Law No. 13,874, dated September 20, 2019, which favors the interpretation of the contract toward the party who has proposed the wording of the contract (in the case of the PPAs, usually the seller/project owner).

These contractual provisions, combined with the principles of the objective good faith and of the autonomy of the parties, support the argument that parties freely contracted the PPA indexed to the foreign currency based on the same interpretation of applicable laws

## Representations and warranties in the PPA

The PPA may also contain representations and warranties from the parties regarding the legality of the PPA denominated in a foreign currency, as well as the parties' capacity to fully assess and confirm that they understand all risks involved in the transaction, including the risk related to exchange rate variation.

## Exclusion of exchange rate variation as a force majeure event

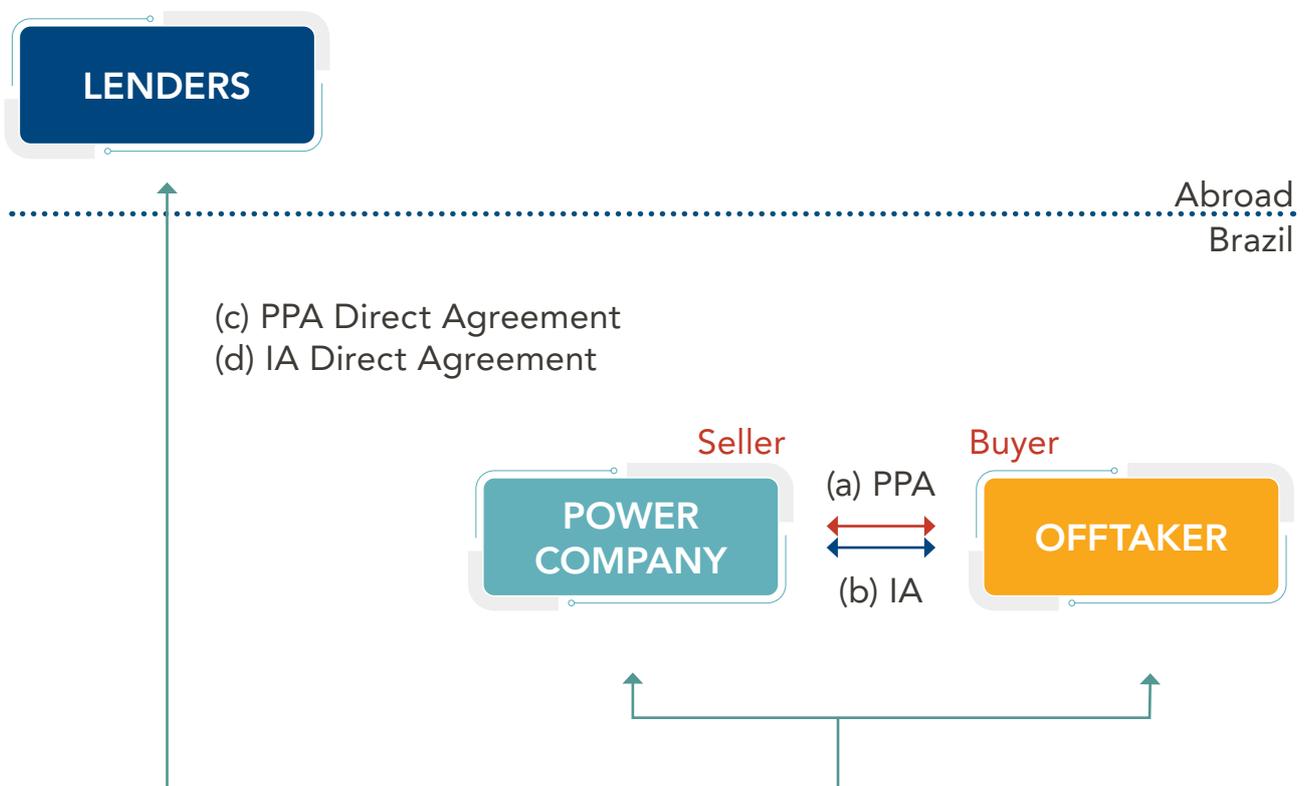
The PPA may determine that an exchange rate variation shall not be considered as a force majeure event throughout the contract's execution, considering that is a predictable event and inserted into the risk assessment of the parties. Accordingly, the parties would not be entitled to any breach of their obligations under the PPA due to an exchange rate variation.

## Termination of the PPA

Challenging the legality of the foreign currency denomination by a party should be an event of early termination by the other party under the PPA and the defaulting party should be subject to pay early termination penalties to the non-defaulting party.

## Indemnity agreement governed by foreign laws

Under international project finance structures, parties have been required to also execute indemnity agreements governed by foreign laws and subject to foreign courts to establish that the party that challenges the foreign currency indexation to the PPA is subject to an indemnity due to the other party. The scheme below demonstrates this contractual structure:



## Subtitles

**(a)** Power Purchase Agreement governed by Brazilian laws.

**(b)** Indemnity Agreement governed by foreign laws.

**(c)** and **(d)** PPA and IA Direct Agreements as required by lender governed by foreign laws.

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We will continue to monitor this topic and keep you informed.



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