

New Public Procurement Act: A New Perspective for Sales to the Brazilian Government

Initial remarks

Brazil is about to have a brand-new legal framework for public procurement proceedings and contracts with the Government on all its levels (federal, state and municipal). The Senate approved the Bill No. 4,253/2020 on December 10, 2020, and following a validation of process of the consolidated text, it was submitted to presidential approval, which is date by April 1, 2021.

Following the approval by the President (which must occur within a 15 business days deadline after the Presidency receives the bill sent by the Congress), the new Public Procurement Act will be published in the Official Gazette and then come into force.

It is a major milestone for the public procurement legal framework, once in a two-year period it will entirely replace the major existing rules concerning government contracts and public tenders. The new Public Procurement Act will substantially impact the routine of governmental entities in Brazil, which have spent an estimated amount of BRL 54 billion¹ in acquisition of goods and contracting of services in 2020.

Overview of the upcoming Public Procurement Act

GENERAL REMARK: A NOT SO BRAND-NEW RULE FOR PUBLIC PROCUREMENT

The new Public Procurement Act comes to scene with high expectations turning the public procurement system into a more agile, less burdensome, and efficient set of rules designed for public tenders and governmental contracts. Our view of the upcoming statute is that it delivers good improvements, especially clarity and consolidation to several topics of the current legislation, which is positive; but it is also true that the new Public Procurement Act does not bring the expected turnaround in the way Brazilian Governments procure goods and services.

MAIN TOPICS OF THE NEW STATUTE

Below we have pointed out brief comments on the main topics of the new legislation that might be relevant for investors and companies intending to do business with Brazilian Government.

Enforcement

The new public procurement statute should enter into force as soon as the President of the Republic signs it into law. However, the new rule also provides for a transition period. For two years after the new law is in force, the public bodies will have the opportunity to choose which statute will rule their procurements proceedings: the one that is currently valid (mostly based on Law No. 8,666/1993) or the new one. It is not difficult to foresee some misunderstandings resulting from the existence of two valid legal frameworks for public procurements, so this is one of the most polemic points of the new bill. It is expected that the regulation of the new statute will bring additional clarification in this regard.

Unification of bidding rules

Brazilian public procurement framework currently has three main statutes: the Public Procurement Act (Law No. 8,666/1993), the Auction Act (Law No. 10,520), and the Differentiated Procurement Regime – or RDC – (Law No. 12,462/2011). The new bill will put the three together into one single statute, compiling the core provisions of each of them.

Clarity

The statute brings clarification to several topics that are doubtful in the legislation to be replaced.

- It sets forth a long list with detailed definition for terms that bring uncertainty under the current regime, such as 'reference sheet', 'preliminary project' (*anteprojeto*), 'basic project', 'risk matrix', 'startup' and 'overpricing';
- It incorporates understandings established in court precedents. As examples, one can point out the extension of suspension to bidding rights (see the item 'Sanctions' below); allocation of risks between government and contractor; parameters that can be adopted by government to establish reference prices; possibility of inversion of phases (competition before qualification).

Incentives to better planning of procurement

A long-term issue in public procurement is the lack of proper planning before the acquisition of goods and services. This circumstance leads to poor procurement decisions, overpricing, and unnecessary acquisitions. In worst cases, the lack of planning leads to substantial damages to the government, sanctions to public officials and severe problems during the performance phase. The new Public Procurement Act creates a 'preparation phase' and provides a wide list of requirements to be addressed throughout this step by the public officials in charge of the procurement. It also creates the 'Annual Procurement Plan', whereby federal entities should make a forecast of all the items to be contracted in the upcoming year. This will allow the acquisitions planned for a given year with the strategic plan and will subsidize the drafting of the budget.

These innovations brought to the statute the best practices that some bodies already adopt in their acquisitions and will have a good potential if well implemented by governments. However, it creates the risk of making the procurement proceedings even more bureaucratic, since the list of inputs for the preparation phase is quite large. Therefore, it will require agility from the public body in order to allow contracts in a timely manner.



New bidding model: competitive dialog

The bill brings an interesting new way of competition in case the required service or good is still unclear for the government. The competitive dialog itself is not a new way for procuring by the government, it was in fact firstly implemented in Europe in 2004², being later substituted in 2014³ for a new directive. In summary, the competitive dialog allows for communication between the public body and potential suppliers with the purpose of designing the best solution for a given public need. Once a reasonable solution is found through dialog, the government then starts a competitive phase to procure the solution designed through the dialog phase. It is important to note that the competitive dialog designed in the new Public Procurement Act is focused on complex contracts or contracts that have technical characteristics that are difficult to be defined solely by the Public Administration.

A few criticisms have already been made by specialists to this new procurement method: (i) the possibility of controlling agencies monitoring the proceeding before the signing of the contract adds an unnecessary layer of bureaucracy to the process; and (ii) the separation of the competitive dialog in the dialog. According to this point of view, the dialog and the competition should compose one single process.

Direct contracts: dismissal and unenforceability of bidding proceedings

A few updates regarding the direct contracts through dismissal and unenforceability of bidding proceedings are also worth mentioning. The concept itself has not changed: waiver (*dispensa*) refers to situations in which theory the competitive process is possible, but there are circumstances that allow the government to dismiss it; unenforceability (*inexigibilidade*) refers to situations in which it is not possible to establish a competitive proceeding (for example, there is one single supplier of a certain good).

- The maximum amounts for dismissal of bidding proceedings were increased: R\$ 100,000.00 for works and engineering services or maintenance of automotive vehicles; and R\$ 50,000.00 for other kinds of services acquisitions;
- Bid can also be dismissed for products destined to research and development (in case of works and engineering services, there is a limit of R\$ 300,000.00);

- Two new kinds of unenforceability were included: (i) the accreditation (*credenciamento*), when several suppliers can provide services or supply goods simultaneously without the need of competition (one good example is the current supply of vaccines against COVID-19, in which several companies provide the good at the same time); and (ii) acquisition or lease of real estate with location and facilities that make its choice necessary.

Risk matrix

This welcome innovation of the new bill is already provided for in the public-private partnerships legal framework and is formally incorporated into the public procurement rules.

The public bodies will have the possibility of including a 'risk matrix' for the contracts to be signed with providers/suppliers, allocating the risks according to what is believed to be the most efficient. The risk matrix is mandatory for contracts of high amounts (higher than BRL 200 million, around USD 40 million) and integrated (*turnkey*) or semi-integrated contracts (see section below about this type of contract).

Performance bonds

Following the example of legislation applicable to public service concessions and public-private partnerships, the upcoming statute gives the Administration the prerogative to request performance bonds guaranteeing up to 30 percent of the original amount of the contract. In case of default, the insurance company must step into the performance of the contract, under penalty of paying the full indemnity limit indicated in the policy. There are several aspects to be addressed in relation to the 'step-in' of the insurer, and at this point there is substantial uncertainty about how and if this mechanism will actually work. Performance bond challenges are: (i) improvement of insurance policies wording; (ii) change in risk underwriting; pricing; (iii) contractual management; and (iv) loss adjustment. But it is indeed a promising opportunity to the (re)insurance market.

Integrated and semi-integrated contracts

This is another interesting innovation of the bill that has already been seen in the RDC statute, mostly applicable to contracts involving construction works. It allows public bodies to contract the construction works, the basic project and the executive project all in the same package (integrated contract, also known as *turnkey contracts*). Currently, only the construction and the executive project can be jointly contracted (semi-integrated contract), not the basic project. It brings to the Administration the possibility of entering into an end-to-end single contract for a certain construction work, which looks more efficient.

Nevertheless, there is criticism to this provision given the uncertainties involved when the Public Administration enters a contract without having at least a basic project. The risks involved (e.g., the substantial risk of several amendments to the projects and delays in the beginning of the executive phase) might significantly impact the final cost of the project and attribute of private construction companies.

Procedure for Expression of Interest (PMI)

PMI already exists in the legislation of public concessions and allows the government to request the private initiative to deliver proposals with studies, research, innovative solutions for matters of public interest. Once the public body chooses the best project, it will open a bid to select the contractor to execute the project resulting from the PMI. The contractor will then pay the fees of the winner of the PMI. An interesting aspect in this regard is that PMI can be restricted to startups.

Efficiency contracts

Performance-based contracts are meeting growing importance in Brazil, especially for infrastructure projects. They are inspired in the international experience of the *output-based procurement* and instead of having compensations based on inputs (i.e., certain contracted milestones that not necessarily result in actual benefits to the Government), they allow the contractor to be paid based on the practical benefits created to the Public Administration. For instance, number of units connected to the sanitation network, or number of students managing to enter the labor market.

Insertion of alternative dispute resolution mechanisms

This is not an innovation in Brazilian Public Law. The statutes that set forth arbitration and mediation in Brazil (Law No. 9,307/1996 and Law No. 3,140/2015) already provide for the possibility of public bodies resolving its disputes through alternative methods. The new bill, however, comes with a specific provision for public procurement and contracts, which brings even more strength to the growing use of alternative resolution methods involving government bodies. The bill expressly allows for conciliation, mediation, arbitration, and dispute boards when it comes to public contracts.

The provision regarding dispute boards is a particularly welcome innovation, given the existence of recent successful cases in infrastructure projects. According to DRBF (Dispute Resolution Board Foundation), only 2 percent of cases assessed by dispute boards in the countries monitored by the organization ended up in litigation before State courts or arbitration. In Brazil, the first experience involving dispute boards was in the construction of Line 4 of the São Paulo subway. In this specific contract, the works were concluded within the expected schedule and the parties accepted the terms of nine out of eleven awards formally issued by the board in charge. The use spread of the dispute boards in infrastructure projects in Brazil still faces some challenges before controlling entities (such as the Federal Audit Court), but market players and law practitioners have welcomed the innovation in the new bill.

Criminal provisions

Despite not bringing relevant updates in the description of conducts treated as procurement crimes, the new bill provides for higher sanctions, harder enforcement rules and longer periods for statute of limitation. Brazil has a long-term tradition of responding to corruption scandals with an increase in penalties. The changes brought by the upcoming legislation are seen as an answer to major corruption scandals unveiled during the Car Wash Operation and more recently the wrongdoings involving acquisition of goods to tackle COVID-19.

Compliance

The new bill brings relevant incentives for the adoption of compliance programs by companies that desire to do business with governmental entities. Until now, the main incentive for a company to have a compliance program is to have reduction of penalties in case it is found liable for wrongdoings under the Anti-corruption Act (Law No. 12,846/2013) or during the negotiation of a settlement.

The new Public Procurement Act provides for not only reduction of sanctions, but also the following:

- Companies that want to enter into contracts with amounts higher than BRL 200 million (around USD 40 million) must have a compliance program in place in no longer than six months after the signature of the contract;
- The existence of a program will serve as criterion in case of draws between proposals;
- When seeking rehabilitation, companies that are debarred from public bids as result of illicit acts provided by the Anti-corruption Act must have compliance programs in place.

Antitrust

The new bidding model (competitive dialog) will demand interaction with the antitrust authority (CADE) to develop some guidelines and best practices for implementation as it may create incentives for anti-competitive conduct. The envisaged pre-bidding conversations between the authority and the bid and potential suppliers may generate incentives for collusion among competitors to rig the bids and/or exchange commercial and competitively sensitive information, which is not justifiably necessary for achieving the best solution for the public procurement. It also calls the attention from the antitrust standpoint the lack of clear rules and protocol regarding the proceedings and leniency negotiations in practices that could be characterized as bid rigging by both the Competition Act (Law No. 12,529/2011) and the New Procurement Law. The bill provides for some clarity about this matter in relation to the Anti-corruption Act, but there is no reference to CADE and the antitrust leniency negotiations.

Sanctions

The new statute brings important updates to sanctions:

- It reduces the discretion of the public body by listing in an objective way which sanction is applicable to each kind of infraction, while the current statute only sets forth the possible penalties (fine, warning, suspension of the right to bid and declaration of disreputable status) without criteria for their application;
- It sets a range for the amount of the fine – 0.5 to 30 per cent of the contracted amount;

- It solves a long-standing problem involving the current legislation, by making clear that the suspension of the right to bid is applicable only to bids and contracts with bodies of the same federal level of the body that imposed the sanction (e.g. if the sanction is imposed by the government of a given State, only other entities connected to that same State can be debarred from public bids and contracts); while the declaration of disreputable status (*declaração de inedoneidade*) prevents companies from entering into contracts with public bodies of governments of all levels – Federal, State and Municipal;

- It makes clear that the suspension of bidding rights is extendable to other companies of the same group – controlled, controlling, and affiliated entities – whenever such other companies are used to overcome the effects of the sanction;

- The bill creates a 'rehab process' for companies that are suspended from bidding or have a disreputable status declared. The following is required: (i) compensation for damages to the Treasury; (ii) payment of the fine; (iii) passage of at least one year of suspension of bidding rights, or three years in case of declaration of disreputable status; (iv) fulfillment of other rehabilitation conditions set forth in the punitive act. In case of conducts that are also wrongdoings under the Anti-corruption Act, or in case of false statements and presentation of false documentation during the bid or contract performance, the company also must demonstrate the implementation or improvement of a compliance program.

While those innovations bring relevant clarification for the sanctioning rules, our view is that some opportunities of improvement were lost. First, the range of possibilities for leniency agreement should be broader, once it is possible only in case of offences under the Anti-corruption Act. It could also encompass settlement between the contractor and government in case of irregularities of any nature detected during the bid or the contractual performance. Second, the minimum period for the sanction of declaration of disreputable status is still too long (three years). Companies that have revenues substantially leveraged by public contracts might not survive during this period.

Leniency agreements

Another innovation of the bill is the inclusion of a possibility of settlement for possible illicit practices in the context of public procurement and government contracts. It strengthens a trend in Brazilian Public Law towards the adoption of consensual solutions to disputes involving matters between contractors and companies. In case of practices that are both illegal under the New Procurement Law and the Anti-corruption Act (Law No. 12,846/2013), the wrongdoer and the public body will have the possibility to enter into a settlement (leniency agreement) that exempts the company from penalties set forth in the New Procurement Law.

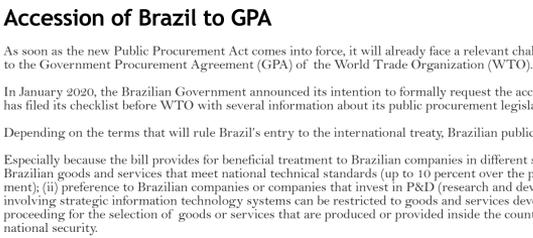
This point used to be a source of legal uncertainty, since an agreement based on the Anti-corruption Act not necessarily prevented the imposition of penalties under the procurement legislation. Besides, the bill also expressly allows the audit courts to exempt the company from sanctions set forth in its legislation by formally agreeing to the terms of the leniency agreement.

This alignment between different sanctioning systems should be an incentive for settlement involving wrongdoings in the context of public bids and contracts. Currently, several bodies have the jurisdiction to impose sanctions, and settlements reached by one of them are not binding on others.

Statute of limitation

The new statute also provides for a period of statute of limitation, which is also an innovation in relation to the current legislation. The application of penalties set forth in the bill will be time-barred after five years counting from the date when the authority became aware of the illicit practice. As in other statutes with similar provisions (e.g., the Anti-corruption Act), it is unclear what characterizes the awareness of the authority (which is the starting point for the counting of the five-year period), but it is a clear improvement in procurement framework.

It is worth noting that under the new legislation the execution of leniency agreements interrupts the counting of time for the statute of limitation. Therefore, once the agreement is signed, the counting of the five-year term is restarted.



Accession of Brazil to GPA

As soon as the new Public Procurement Act comes into force, it will already face a relevant challenge: to seek consistency with the accession of Brazil to the Government Procurement Agreement (GPA) of the World Trade Organization (WTO).

In January 2020, the Brazilian Government announced its intention to formally request the accession of Brazil to GPA. On October 5, 2020, Brazil has filed its checklist before WTO with several information about its public procurement legislation, which will be now assessed by the organization.

Depending on the terms that will rule Brazil's entry to the international treaty, Brazilian public procurement legislation will need to be amended.

Especially because the bill provides for beneficial treatment to Brazilian companies in different situations: (i) granting of a preference margin to Brazilian goods and services that meet national technical standards (up to 10 percent over the price offered by competitors that do not fill the requirement); (ii) preference to Brazilian companies or companies that invest in P&D (research and development) in the country in case of tiebreak; (iii) bids involving strategic information technology systems that are restricted to goods and services developed in the country; (iv) dismissal of competitive proceeding for the selection of goods or services that are produced or provided inside the country and that involve high technological complexity and national security.

The entry of Brazil into the GPA will definitely bring good opportunities to Brazilian companies abroad. Currently, GPA has 29 members, including the United States and the countries of the European Union. The Brazilian public procurement in general should also benefit from it, once new competitors, with new technologies, services and goods will be encouraged to enter Brazilian public market.

However, the country has a long tradition of protection to its internal market. The new Public Procurement Act reflects it. The update of its provisions in this regard is indeed a major challenge for the upcoming years.

¹ According to *Portal da Transparência* official website, in 2020 the Brazilian Government carried out 130,988 bidding processes (including regular bidding processes, waiver of bidding process or non-requirement of bidding process) that summed approximately BRL 54 billion. More information available at: <http://www.portaltransparencia.gov.br/noticias/ano-2020>

² Directive No. 2004/18/CE, available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32004L0018&from=EN>

³ Directive No. 2014/24/EU, available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0024>

Environmental, Social and Corporate Governance (ESG)

The old statute already expressly provided the "national sustainable development" as a pillar to the national procurement proceedings and some incentives to adoption of good ESG practices by contractors.

The new bill brings new incentives in this regard, such as:

- In case of illegality in bidding in proceedings and contracts, the public body must consider social and environmental impacts of the contract during the assessment of possible termination;

- The remuneration of the contractor can be set based on performance, which will be measured according to criteria of environmental sustainability, quality standards, and deadlines;

- Adoption of compliance program by companies that enter into contracts with amounts higher than R\$ 200 million (or for rehabilitation in case of imposition of certain sanctions);

- The reference sheet of the procurement proceeding must include description of social impacts, mitigating factors, low energy consumption requirements, reverse logistics for recycling.

- The bill also prohibits the participation in any public procurement of people and companies that have been rendered a final and binding ruling for child labor; submitting workers to conditions analogous to slavery or for hiring adolescents in unlawful cases;

- Government entities can demand from its contractors that a minimum percentage of the work force in charge of performing the contract be composed by women that suffered domestic violence or citizens that left the prison system.

Despite the positive advances in Human Rights matters related to labor conditions, the bill failed to provide for the breadth established by the National Directives on Business & Human Rights (Resolution No. 05/2020). The National Directives provide that the Public Power will cease any contracts or relation with companies involved in Human Rights violations resulting directly or indirectly from its activities. The bill does not expressly encompass other forms of Human Rights violations and those caused indirectly by the person or company.

Newsletter content developed by TozziniFreire

GERMAN DESK'S TEAM:

✉ Claudia Bonelli | PARTNER

✉ André Camargo | PARTNER

✉ Gabriela Lima | PARTNER

✉ Carolina Dotto | ASSOCIATE

For more information, please visit:

<http://tozzinifreire.com.br/areas-de-atuacao/german-desk>

TOZZINIFREIRE

A D V O G A D O S

tozzinifreire.com.br