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Tenth Anniversary of Regulatory Agencies in Brazil: Problems and Challenges

FREDERICO LOBO DE OLIVEIRA

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SECTION 1 - INTRODUCTION

This paper intends to analyze the regulatory agencies' role in the Brazil in order to show some of the current problems that affect both directly or indirectly the regulatory environment.

In order to understand the agencies in Brazil at the present moment, a briefing of its origins, the concept and main features will be presented. Since their inception, which happened ten years ago, and after overcoming their first phase, the regulatory agencies have begun their aging process, which should bring strength and legitimacy to their actions.

Brazil has consolidated its economic fundamentals, with a development model based on market reforms, outward orientation and sound fiscal policy. Considerable progress has been made in recent years in achieving macroeconomic stability and restructuring the economy.

Many regulatory achievements to ensure economic growth were already reached in the last decade. However, many obstacles still need to be overcome, so the regulatory agencies will be able to play their role efficiently as a State organ and not as a Government body. This is a common misconception held by other institutions.

Some matters coming from the Executive, the Judiciary and sometimes even from the Legislative branch have been a constant concern because they challenge the technical position and the independence that the regulatory agencies should have.

This work will show some cases under discussion among regulators, investors, customers and the Federal Government, which adversely affect and hamper the stability of the regulatory environment and the regulatory agencies` role, without trying to downplay other hypothesis. Although it will demonstrate cases related to the energy sector, with special attention to the

ANEEL (National Electricity Energy Agency), all others infrastructural regulated agencies face the same problems.

The Legislative body has a fundamental part in the definition of the regulatory agencies' real power. A bill was proposed in 2004 with the objective of creating a general law to standardize and define the regulatory agencies' principles and enacted limits. The Brazilian National Congress, however, has not voted it up to now, illustrating that it is not a simple issue.

The first part of this paper considers the state reform and the creation of the institutional and regulatory environment. The second part sets the main features, the functions, purposes, and the characteristics of the regulatory agencies. It also presents a more specific view of ANEEL`s competence. The third part will show some of the current problems such as interference in regulatory issues.

Finally, after this brief exposition on the subject, this paper will raise some questions to what extent of the regulatory agencies should be independent in order to accomplish their respective tasks in order to improve investment climate.

SECTION 2 - STATE REFORM AND REGULATORY STATE

Montesquieu and John Locke's writings constitute the theoretical basis that has been carried out in most Constitutions of the Occident since 18th century[1], based on the principle of the separation of the powers.

Both aimed the same objective while conceiving such ingenious theory to avoid arbitrary will, whose occurrence is inevitable when the essence of the power is accumulated on the same hands. As an outcome, arises the idea of dividing the State's roles, attributing them to three different powers, and to institute mechanisms so that each one can interact and control immoderation through the theory of the checks and balances. [2]

In his masterpiece, "The Spirit of the Laws", Montesquieu synthesizes the theory of the contention of powers. It is based in the idea that every man who retains power is prompted to use it abusively until finding limits. The virtue, then, needs limits. In order to avoid abuse of power, are necessary that the power limits power.

[1] The principle of the separation of the powers supported the first written constitutions, especially the 1787 American and the 1791 French one and have become renowned and an obligatory content of almost all constitutions promulgated ever since.

[2] In the United States, they are applied in doctrine and especially in the jurisprudence of the Supreme Court. Robert Jackson, then member of the Supreme Court, synthesized the formula of separation containment of powers:«While the Constitution diffuses power the better to secure liberty, it also contemplates that practice will integrate the dispersed powers into a workable government. It enjoins upon its branches separatedness but interdependence, autonomy but reciprocity».

The principle of the separation of the powers, which bears the corollary of prohibiting thoughtless delegation and the concentration of the essence of the state power in just one of the three Powers, constitutes an element that cannot be bypassed in the modern constitutional theory.

However, the State conceived out of political-philosophical works by Locke and by Montesquieu has gone through deep changes.

By the end of the 19th century and beginning of the 20th most of the countries were driven by the obstinate worship of nonintervention dogma on behalf of State in the private economical relationships. The United States became known as the nation-symbol and election land of the so-called economical laissez-faire. Such period, however, was replaced gradually, from the beginning of the 20th century on, by the intense presence of the State.

The world beheld the emergency of an interventionist State, provider of actions inclined to minimize and correct imperfections and iniquities of the capitalist system.

Changes were so profound in the role entitled to the States in economical matters, especially in the US, that some authors agree of qualifying them as a true regime change or as a bloodless revolution.[3]

It is consensual that the mutation caused by structural modifications in the society, had a consequence for the political institutions sight: the dawn of changes in the means of classic state functions executing, with the introduction of the regulation phenomenon.

As it is understood these days, the regulation is a sort of indispensable corrective to two processes that are intertwined. On one side, it concerns about remedial actions to the wounds and

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deformations caused by capitalist regime. On the other side, an amender to the operating way of the State's machinery created by the capitalism itself.

The regulation idea, in this context of irrepressible need of intensification of the State's rectifying presence in the capitalist game, was born as an irrefutable government function, mainly in the United States of America[4].

Introduced in North American Right in the last decades of the 19th century, the regulatory agencies became solid in the USA from "New Deal" forwards, which is considered to be the great governmental change posture occurred in the USA under Franklin Roosevelt's lead, accomplished to withdraw the country from crisis.

Such rupture marks, as it is known, the beginning of "the regulatory state". That is a highly interventionist State in economical matters, which is instrumentally and accurately performed through agencies.

In Brazil, the regulation arises in a context entirely different from the American institute. The principal actor was indeed the State that was active in the economic field although not effective.

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[4] Verifying the deficiencies of both judicial and legislative roles in the laissez-faire period, James M. Landis say that the new State's regulatory function represents an attempt to repair such institutional deficiencies, clearly marking: *«The administrative process is, in essence, our generation's answer to the inadequacy of the judicial and the legislative processes. It represents our effort to find an answer to those inadequacies by some other method than merely increasing executive power. If the doctrine of the separation of power implies division, it also implies balance, and balance calls for equality. The creation of administrative power may be the means for the preservation of that balance, so that paradoxically enough, though it may seem in theoretic violation of the doctrine of the separation of power, it may in matter of fact be the means for the preservation of the content of that doctrine»*.

Traditionally the provision of infrastructure services in Brazil was performed by state-owned enterprises. However, severe macroeconomic crises had limited the state-led expansion, and the financial resources of public authorities, what reduced capital transfers to those companies and forced them to cut down on investments.

Major changes were introduced in order to relieve the State from the burden of high cost of investments in infrastructure. The State without resources to provide enough investments in these areas was obliged to reduce their activities in those segments that could be completely performed by companies of the private sector, allowing State activity to focus its efforts in social areas. This change benefits private investors that renewed investment in infrastructure and also the State that could finally perform other priorities.

At that moment, the belief was that these changes could be sufficient to attract investment and trigger further incentives for growth, resolving some long standing deficiencies of previous public activity. It would also help to improve performance, coverage, and facilitate access to services on a market basis.

So, the Brazilian economy was greatly transformed during the past two decades, through a historical move towards liberalization, privatization, deregulation and the consolidation of a competition-based economy, which ended a long period of uninterrupted State intervention in the economy.

The institutional, administrative and legal settings also have evolved rapidly. Significant steps were taken in terms of competition policy.

The most remarkable transformations aimed to increase competitiveness and restrain the role of the State role in the economy were: the abolition of some restrictions to foreign capital

(constitutional amendments 6 and 7 from 1995); greater flexibility for the state monopolies (constitutional amendments 5, 8 and 9 from 1995), which modified key aspects of the Brazilian economic order, giving the possibility to States to grant concessions of some public services to private companies; the introduction of the framework for privatisation of public companies providing services.

Under the new constitutional system, the cases of public monopoly are exceptions to the principle of free competition. State involvement in economic activities concurrently with private enterprise must be considered equally exceptional. This kind of activity by the State is allowed "only when necessary to defend national security or a vital collective interest, as defined by law"[5]

After these major changes, a new institutional framework for regulating economic sectors was required to achieve States objectives like attract new private investment, including from abroad, increase efficiency and reduce the public debt. It included a quick setting up of a number of regulatory authorities to oversee newly privatized and/or deregulated sectors.

The Brazilian government has succeeded in many aspects of the proposed reform. It has created a new legal and regulatory framework, defined new trading arrangements, implemented the necessary institutional changes in the government and modernized competition law.

As a result of the new environment, 10 federal regulatory agencies have been created since 1996 on the basis of the new order constitutional: National Electricity Energy Agency ANEEL (1996), National Telecommunications Agency ANATEL (1997), Brazilian Oil Agency ANP for Petroleum (1997), ANVISA for Food and Drug Admission to the Market (1999), ANS for private health insurance (2000), ANA for water (2000), ANTAQ for ports (2001), ANTT for

[5] Article 170 e 173 Federal Constitution

land transport (2001), ANCINE for the movie industry (2001) and ANAC for civil aviation (2005). In addition, the Administrative Council for Economic Defense (CADE), which had been created in 1962, was transformed into an independent governmental body, with clear powers for competition policy enforcement.

Therefore, from the late 1990`s on, regulation began to assume greater importance, running the State as supervisory and advisor of economic activities competitive constitutionally characterized as a public service.

SECTION 3 - REGULATORY AGENCIES: CONCEPT AND MAIN FEATURES FOR INDEPENDENCE.

The regulatory agencies are, in essence, typical bodies of the 'welfare state'. They aim to monitor the intervention of the government in the economic field, once Legislative Power chooses to leave regulation matters to specialized administrative entities independent of the current government.

They are empowered to standardize, organize and supervise the provision by public and private economic agents of certain goods and services of sharp public interest. In addition, they also set the rules of conduct between the Public Power, the service provider and the customers, as well as ensure the quality of public privatized services.

Their creation is justified by the complexity of certain tasks that require expertise knowledge and sufficient agility for rapid implementation of public policy. They are essentially technical entities, aiming to ensure the economic and financial balance in supply of a service provided to the population and operate in sensitive spheres of public life such as Health, Energy, Transportation, Communications, Commerce, Securities and Exchange.

The most important duties of the regulator include: implementing the governments` policy; regulating competition involving the effective enforcement of fair and equitable competitive market principles; restraining the power of dominant suppliers and leveling the playing field for new entrants; minimizing the burden and costs of regulation and contract enforcement.

Such bodies also have been set up to protect decision-making and enforcement in the sector from short-term political considerations, as well as, protect private capital against unstable policies.

The regulatory bodies also exist to ensure a balance between the interests of the diverse players, such as the government (which is sensitive to political demands), consumers (who always want lower tariffs combined with a better quality of service) and regulated companies (that need to ensure their return for the resources invested). To find the right balance, therefore, the agencies need to combine economic vision, technical expertise and political sensitivity - a jurisdiction which requires the existence of highly skilled professionals who are independent of groups` pressure.

The agency must be independent to make any kind of technical decision. The agency must not give in to the government's immediate interests. The agency cannot agree with consumers' requests that will eventually result in investments' discontinuance and will consequently affect the service, and it must not agree with the companies in requests that will harm the consumer.

The decisions made and the procedures used by regulators shall be impartial and transparent with respect to all market participants and should result in a fair level-playing field.

The agencies` behaviors are also based on ensuring non-discriminatory treatment of all players in the liberalized market. The central issue is establishing functioning, enabling an environment (regulator(s) and regulations) that will attract sufficient and sustainable investment to satisfy existing demand, expanding supply and introducing new services.

In order to assure these goals, there are three fundamentals to achieve and guarantee independence:

(A) Political autonomy: providing the regulator with a distinct statutory authority, free of political control, prescribing well-defined professional criteria for appointments, fixed terms of office for director or commissioner, and prohibiting their removal.

(B) Management, financial and budgetary autonomy: providing the agency with reliable and adequate alternative sources of funds to ensure its activities. Optimally, charges for specific services or levies on the sector can be used to fund the regulator to insulate it from political interference through the budget process.

(C) Technical decision autonomy: providing technical decision-making that ensures the apolitical role of the agency with predominance in technical discretion over political discretion. It leads to policies that best serve public utility services rather than unwise or shortsighted political concerns, and helps insure against undue influence by special interests.

The regulatory agencies are generally designed to have some especial institutional features that enhance their independence and insulate their decision-making process from political influences. As a result, the regulatory process is not politicized and the regulators decisions are not discredited.

The fixed term of office and the lack of removal power are one of the most important institutional guarantees of independence. It means that the President, who appoints the regulators for a certain period of time (mandate), is deprived of the power to remove the agencies'

directors. If the President had this power, he could remove those directors who might make decisions that displeased him. He would be able to treat the agencies` decision-making freedom.

Collegial decisions are another guarantee of independence. The collegial decision-making process reduces the possibility of Presidential or other political influences, because it is harder to influence an agency headed by a board than one sole director.

There are many other features used to limit the political influence, like the existence of staggered terms of office, so the directors can be replaced only gradually by each successive government. Longer terms of office also guarantee a higher degree of independence.

These features aim to provide a high level of independence to Brazilian agencies and should reduce the risk by insulating the regulatory framework from the political sphere. Nevertheless, it is essential that these guarantees are effectiveness. Unfortunately, this is unlikely to occur as we will see in the next chapter.

There is no doubt that the introduction and strengthening of an independent and a neutral sector regulation has helped to reinforce investors` confidence and market performance, while enhancing consumer benefits. However, by the regulatory agencies actions, conflicts with other authorities are always present, for example the executive branch, the prosecutor, the courts of accounts, in addition to the Judiciary itself.

3.1 - NATIONAL ELECTRICITY REGULATORY AGENCY – ANEEL`s OVERVIEW

In general, regulatory agencies in Brazil are public autonomous entities under a special regime, therefore part of the indirect administration. This special regime means that a regulatory agency has management, financial and decision autonomy. It also guarantees that the regulatory agency is not subordinated to any Ministry.

They are not administrative entities from the current Government, but from the Brazilian State and they have been created to bring equilibrium to different interests among the Government, the regulated companies and the consumers.

Modeled on the concept of independent regulators, ANEEL emerged from the restructuring of the electrical sector. It started its activities on December 2nd, 1997, following the enactment of Decree 2,335 of October 6, 1997, which establishes the directives to be followed by the agency, its powers and responsibilities, its governing and administrative structure.

The Brazilian Electricity Regulatory Agency (Agência Nacional de Energia Elétrica-ANEEL) was the first agency to be created and it was instituted, through the Law 9427 of December 26th, 1996, as a federal body.

The Agency is member of the Indirect Federal Public Administration, connected to the Ministry of Mines and Energy and it is legally qualified as a “special autarchy”, characterized by administrative independence, absence of hierarchical subordination,

ANEEL is an independent body. It is managed by a collegiate Board of Directors, composed of the General Director and four others, appointed by the President and confirmed by

Senate. The executive functions are under the responsibility of twenty superintendence. Their decisions are not reviewed by the government or other administrative entity, except by the judicial branch. ANEEL has financial autonomy provided by the annual collection of inspection tax paid by all energy consumers.

ANEEL`s mission and objectives is to regulate and monitor the production, transmission, distribution and supply of power, according to the policies and directress established by the federal government, and to establish conditions for power market development which balances the interests of market players for the broader benefit of society.

It mediates conflicts of interests among industry players and between these agents and consumers; moreover, it grants, permits and authorizes electric-power facilities and services, stimulates and ensures fair competition in the electric energy industry as well as free access to electric systems, and warrants fair electricity rates. In addiction it attends to the quality of services, enforces investments by regulated entities, educates and informs industry players and society about energy policies, guidelines and regulation.

The Agency is responsible for inspecting the generation, transmission, distribution and commercialization of electric energy. As a tool to accomplish with its mission, ANEEL can impose sanctions, once the agency has legal competence in applying administrative penalties to the agents.

SECTION 4 –CURRENT PROBLEMS OVER REGULATORY ISSUES

The discussion about setting efficient regulatory framework in Brazil has been for many years mainly focused on the institutional design of regulatory agencies. However, this has happened without a broader dialogue among core government institutions, the Congress and the judiciary branch.

It has led to a fragmented process without a general directive guideline, which has created a misunderstanding about the regulatory mission and the State role in economic issues. The lack of consensus in the exact function and responsibilities of regulatory agencies is an important concern and has so far resulted in diminishing outcomes for Brazil.

Although after ten years of existence, there are many kinds of problems that undermine the regulatory environment for securing a well-functioning market.

Some of the problems, such as interference in agencies` functions from other State bodies (e.g. the Federal Court of Accounts and the Courts of Justice), have been clearly weakening the regulatory framework and the agencies independence.

Before showing some specific cases of interference, it should be pointed out that in the Brazilian scenario the bonds between the regulatory agencies and the President are stronger than with Congress.

The fact that the executive branch was the main proponent of regulatory reforms resulted in major influence of the President over independent agencies. In this framework, the Executive branch has strong control, which reduces Congressional power to change the statutes of agencies and limit Presidential discretion.

The regulatory agencies have received considerable rule-making power in core infrastructure sectors. It might create many different situations in which the regulation can affect, overlap or conflict with governmental policies or macroeconomic targets. In other words, rule-making power of agencies can go against the government interests. This is why the President may have strong incentives to interfere in some of the regulatory decisions. If he will be held electorally responsible for what regulatory agencies are doing, it seems reasonable that he has strong incentives to try to influence them to implement popular policies, when regulatory agencies decisions politically affects the government interests.

For example, the President could pressure ANEEL to reduce the electricity rates to benefit residential consumers or to control inflation.

The last two AMCHAM - American Chambers of Commerce in Brazil reported that in 2006 and 2007 at least half of the investors in the electricity sector perceived the regulatory electricity agency to be excessively or highly influenced by the Executive branch. The same AMCHAM`s report describes survey responses of investors, consumers and associations of the electric sector. The responses indicate the investors` perception that the Executive branch interferes in regulatory functions`.

Now, this paper will demonstrate some of the main concerns related to the regulatory environment that have been under discussion among investors, customers and the Federal Government, without trying to exclude other hypothesis that affect and hamper stability.

4.1 - LEGAL AND REGULATORY FRAMEWORK

The Brazilian Congress and the government have an important role in promoting regulatory stability. As they establish the legal and regulatory framework (i.e. by law and by Presidential decrees), both have the responsibility to define the main policy guidelines of the regulatory agencies.

First of all, as a result of the increase of regulatory activity, a large flow of legislation has been produced by the federal administration. The current regulatory framework in Brazil consists of several laws complemented by secondary legislation, when have accumulated since the start of reforms in the mid-1990s.

However, the institutional arrangements are not sufficient to build capacities across the whole administration, to create co-ordination mechanisms between institutions, and to improve the quality of legislation.

The large number of legal instruments has caused legal and regulatory confusion because there are texts that are obsolete, partially outdated or superimposed onto other legal norms. New laws and regulations are not subject to quality control mechanisms, although formal procedures are used for preparing them.

As a result, the countries` legal framework remains complex and uncertain. The burden resulting from a large number of federal laws and regulations without coherence often represents a risk environment and the country has been loosing competition because international investors don't have enough trustful in the Brazilian legal and regulatory framework.

Other current concern about legislative procedure is the possibility of amendments to a bill without adequate discussion (i.e. with relevant regulatory agencies) or approval of the bill`s creator, usually the executive. The increasing role of congressman in amending legislation has significant implications in terms of regulatory stability, quality and for the co-ordination of regulatory policy. For example, the *Low Income Program* was introduced in Law 10,848 through an amendment to the draft law and without a general discussion, even with the executive branch who originally proposed the bill.

These amendments, often attend to the personal interests of one or another Congress member or other interested groups without taking into account the whole system. However, it is important to stress that the benefits created for a particular group always overloads and burdens other consumer groups or the whole country.

In some places, the bills and their amendments about a specific regulated theme must be previously forwarded to the regulatory agency to have its opinion. Thus, there is a formal speech by the regulatory body, which provides technical information in order to clarify the possible impacts of Congress` approval of a new law in the context of the specific sector. However, in Brazil it has not happened yet.

Moreover, the functions, responsibilities and competencies for each one of the political entities involved in regulatory issues are not always clearly defined. For example, ANEEL was in charge of issuing new regulation specifying details of a new system of public bids for the sale of electricity produced by new plants. In its original draft, ANEEL decided that unforeseeable costs could be transferred into the final rate (once they had been audited and approved), thus ultimately transferring these costs to consumers. One day after the regulation`s draft was publicized, the Ministry of Mines and Energy enacted a decree officially instructing ANEEL to

modify the regulation's terms which forced the investors to bear the risks and unforeseeable costs of these new projects. The statutory provisions[6] say that is under ANEEL`s jurisdiction to regulate public bids for new projects. But it also says that ANEEL should do so according to the guidelines defined by the Ministry.

Conflicts among Brazilian authorities are frequent, not only because of an uncertain level of competence, but also because of poor drafting, and the complexities and deficiencies of the legal and regulatory system.

The existence of gaps and a lack of precise definition and clarity in some parts of the legal framework have been creating ambiguities and reducing the effectiveness of the appropriate government and regulatory body action. These issues are pending in Brazil, often ending in legal and regulatory uncertainty and conflict, creating unnecessary costs for businesses and citizens.

Moreover, general issues of significant importance including long term planning and strategic planning need to be resolved to enable regulatory authorities to fulfill their task of enforcement.

4.2 - AGENCY BUDGET CONSTRAIN

Although one of the key institutional guarantees of agencies` independence is alternative source of income, it might become ineffective if government control and interference with regulatory agencies' budgets occurs.

[6] Statute 9,426, article 2

The Brazilian President, clearly violating one of the fundamentals of the regulatory agencies, has substantial control over their budgets. The President has the power to interfere significantly in the federal appropriation process as part of the executive fiscal accounts through the contingency procedure.

The process of formulating the budget allocations for one particular fiscal year starts with a budget proposal that is prepared by the Secretary of Federal Budget. This department, as the American Office of Management and Budget - OMB, receives information from all agencies and offices of the Executive branch to be analyzed and reviewed. Then, the regulatory agency budget is incorporated in the presidential budget that is sent to Congress for approval.

Nevertheless, even after the law was enacted, the President can modify the congressional appropriations according to his own discretion. These changes are made through presidential decrees, which are not subject to any Congressional control. In contrast, in the American system any changes made by the President such as imposed delays or cancelled budget resources are subject to Congressional control.

In sum, there is no guarantee that even after their approval by Congress, the resources allocated to a regulatory agency will necessarily reach it, because the President still has control over the amount of funds that the agencies will actually receive.

ANEEL's budget comes from the Inspection Tax paid by all energy consumers. According to law, these funds are earmarked, meaning that the law forbids the use of them for purposes other than exclusively by ANEEL in order to support its activities that benefit all consumers. However, part of its revenue has been retained over the years.

GRAPHIC

The numbers indicate a year-to-year strengthening in the budget constrain. The President has been using regulatory agencies funds to achieve government's targets for fiscal surpluses. It means that Brazilian Federal Treasury has retained part of the tax collected through those specific levies defined in laws.

Agencies must be confident of their funding. The power to undermine the agency`s budget might damage or eliminate regulatory functions. Financial autonomy has an important role and the existence of stable and predictable resources is important to consolidate their operations, such as supervision.

Regulatory agencies with a restricted budget cannot develop its activities as expected. Besides that, if they are financially dependent on the government, they can also be compelled to make political decisions. The President`s power to unilaterally control the agencies` resources can operate as an incentive for agencies to adopt his preferences, under the threat of budget reduction. That is why a regulatory agency must have its own budget and not depend on the government's financial transference.

4.3 - STATE-OWNED COMPANIES

The relationship between the executive branch as government and as a company shareholder is another current regulatory concern. It is because the rules of governance for publicly-owned enterprises which define the objectives and the boundary conditions between State-owned enterprises and the public administration remain unclear.

In the past, those state-owned companies did not always receive proper incentives, as they were management to be responsible to short term policy objectives. This opened opportunities for political patronage and their complete inefficiency.

Despite some successful stories, state-owned and investor-owned companies sharing competitive markets are always controversial and the current regulatory system is not well-designed to guarantee effective supervision or prevent abuse by dominant state-owned companies and guarantee the competitive neutrality desired by investors.

The regulatory framework hasn't adapted to a market-based situation in which the State had to distinguish its function as a regulator, policymaker and owner of companies in order to offer a neutral environment with a level playing field for all market stakeholders.

State-owned companies serve several purposes. They participate both in natural and legal monopolies, and as partners of investor-owned companies, they carry out special projects of strategic or social value for the government. Moreover, they may compete with investor-owned companies.

There are a number of ways in which state-owned companies can undercut private competitors, including cross subsidization of activities as generation and transmission, and soft financing conditions from the government. The government can also employ them as price-makers, preventing market power abuse by private competitors.

In the case of the electricity sector in Brazil, where the privatization was not completed, the State still has a major shareholder responsibility. "Eletrobrás", for example, which is still majority state-owned, is the holding company of the largest generation and transmission group.

The remaining state-owned companies have also become a powerful interest group and can affect the regulatory environment.

The regulator has faced a challenge to prevent the State-owned enterprises from taking advantage of a potentially privileged position, even without a clear definition of the roles to be played by the state-owned electricity companies in the sector. This is important in a market in which private investors are competing. However, the regulatory agency has to have the necessary independence to assure investors that they will get even-handed treatment and ensure that competitive neutrality occurs.

4.4 - BILL 3,337/04

The Bill 3,337/04 has stimulated the political debate in the last four years and over time, the policy perspective has been modified (more than a hundred amending so far). The bill known as the Regulatory Agencies' General Law defines rules to be applied to the regulatory agencies regarding their management, organization and social control mechanisms.

The proposed law intends to reform the Brazilian regulatory environment in order to attract more investors. The bill aims to join all the laws related to the several Brazilian regulatory agencies and, consequently, to consolidate the rules regarding the regulatory framework. Therefore, all stakeholders will be able to deal with a uniform, clear and comprehensible legislation.

However, while this new bill helps to address a number of challenges in terms of closing the social gap and improving conditions for consumers, some aspects have also been a matter of

concern. Some proposals from the bill tend to weaken agencies' autonomy and increase the perception of regulatory risk.

Two aspects of the bill generate concerns for both the investors and regulators: the recasting of the Ombudsman and the establishment of management contracts between the regulatory agencies and the ministries to which they are connected. These two concerns can represent a "serious setback" because they might muzzle the agencies so then they act as the government wants.

Ombudsman is a professional that is present in almost all public entities in Brazil and to whom any citizen has the right to make a direct complaint. He is responsible for acquiring, revising and forwarding any complaint, suggestion or praise related to the procedures and actions of consumers, agents, agencies or entities.

The establishment and strengthening of the ombudsmen in Brazil is desired because it certainly represents a useful tool for channeling the public's view in a context where some voices find it difficult to be heard. But it may be important to this in a way that does not undermine the regulator's autonomy.

The proposal law, in effect, is considered a regulatory point of instability. It has changed the current ombudsman characteristics and it has caused strong criticism by the experts in regulation and the private sector.

Today, one of the members of the board of directors is the agency ombudsman and reports all complaints to the board and addresses the problems. The proposed law creates another position without directors responsibilities. The ombudsman will not participate and vote in the agency deliberative meetings, despite having all the powers of a director, such as a fixed turn of

office. He will also be appointed by the President, without going through the Legislative approval.

The project of law gives him wide powers and the duty to produce biannual reports to various ministries. It becomes a kind of "sheriff" of the government on the agencies behavior, having access to all processes, including top secret ones.

The fact that the new ombudsman has to forward reports on the functioning of the agency and the conduct of the leaders (Directors and Superintendence) has been seen as a mechanism of control, coercion, or at least, intimidation.

The ombudsman's presence unbalances the governance of the agency in favor of the government. In an environment in which it seeks parity between public or state-owned companies and private enterprises, the figure of the ombudsman is a public servant with a direct channel with the current government. This position becomes a point of doubt for private actors and technicians regulators, because the ombudsman will have access to information at first hand and may not have the necessary impartiality.

Another point of concern is the proposed management contract. It was originally introduced to ensure accountability between the ministries and the agencies, but it has not been put in practice since the creation of the regulatory agencies. However, the management contracts that had been proposed by Bill 3,337/04 were probably not suited to strengthen accountability, as they would have had implications for agencies` independence.

Through the management contract instrument, the bill established that the government could set productivity targets for agencies conditional to releasing resources. It would fit the regulatory activities within the government programs as it introduces a new layer of controls,

without necessarily reinforcing accountability. The government would have another mechanism of control over agencies duties.

The first version of the Bill 3,337/04 concerning the management contracts was a reflection of such a tendency. However, the debates over the last year have already led to some changes, with significant modifications to the management contracts which had been proposed initially.

If regulators are to perform their mission and enjoy some independence in their relations with their parent ministry, ensuring accountability is crucial. However, the regulatory agency must be recognized and maintained as a technical and an autonomous body, under penalty of irreparable harm to the quality of the institutional environment.

4.5 - FEDERAL COURT OF ACCOUNT

The Brazilian Federal Court of Account is the government body, which is part of the legislative branch. It is in charge of inspection and accounting, financial, budgetary, operational and patrimonial audits over any public or private agency, that utilizes, collects, keeps, manages and administrates public funds, for which the Federal Government is responsible.

Thus, the Brazilian Federal Court of Account holds the competence of surveillance only of activities which involve public resources. Although regulatory agencies are subject to the audit of the Federal Court of Account and provide management report to it, many determination of this body have extrapolated their competence limits as we shall see below, which have been generating legal and regulatory uncertainty.

The regulatory agency's purposes are exclusively given and defined by law, including their rulemaking power over a specific field. In the electricity sector, one of the Brazilian agency duties is to proceed the tariff revaluation of Electricity Distribution Concessionaires, which is fixed by law and by concession contracts.

The law also ensures ANEEL the technical discretionary powers to establish the revalue methodology. This practice takes into consideration the examination of enterprise cost structure and of market *status quo*, comparing them to the tariff levels on both national and international context. This stimulates the concessionaire economic efficiency in order to make tariffs reasonable, preserving, thereby, the economic-financial balance of concession contract.

Not withstanding the exclusive regulatory competence of revaluing tariffs, the Federal Court of Account has been issuing determinations to the agency, wholly or partially obstructing the technical assignment of the regulatory organ[7]. In sum, there is a clear interference in the methodology adapted by ANEEL to the tariff reset calculation of electric energy.

It creates judicial and regulatory instability and weakens the concession contracts` compliance. If the Federal Court of Account could actually overpower ANEEL's assignments, there would be a doubt concerning the final decisive instance about the matter, bringing forth the veto power of the auditory organ over the regulatory one, in a subject within the latter's scope.

As the Federal Court of Account issues determinations related to ANEEL's performance, the former surpasses the boundaries of its sphere prescribed in the Federal Constitution (art. 70 e 71), performing an unwarranted intervention on regulatory issues.

[7] Brazilian Federal Court of Account. Decisions: TC 015.402/2001-1; TC 016.128/2003-2; TC 007.371/2003-5, TC 002.739/2003-7

The Brazilian Supreme Court (STF) has already examined similar cases regarding the Federal Court of Account determinations, realizing that they have decisive charge and harmful efficacy, which allows the Supreme Court to remove the threat of damage to legal rights.[8]

ANEEL's activities can and shall be supervised by Congress, by any organized civil society or any citizen. It also shall be overseen by the Federal Prosecutors' Office, which will conduct their demands to Judiciary Power, as well as participate actively in administrative proceedings within the agency field of action and in those which affect public interests.

The extent to which assessment, advice or determination from the Federal Court of Account is applied to the agencies can not undermine the agencies autonomy and its technical capacity. Unfortunately, it has been happening in Brazil, and also has been increasing the risk perception and the regulatory uncertainty.

4.6 - TAXATION

Although the taxation is totally outside of regulatory agencies` responsibilities, it has significantly affected the regulatory environment and the principle of moderate tariffs. It has turned out to be one of the biggest investors, consumers and regulators` concerns.

The tax burden that takes place upon the Brazilian products and services, especially in the electrical sector, is one of the highest worldwide, if not the highest one, overcoming countries such as Austria, Norway, Italy, France, United Kingdom and United States.

[8] Brazilian Supreme Court. Decisions: MS 21797-RJ e MS 21519-PR

Almost half of the balance due in a light bill corresponds to taxes and duties collected by the government. A research accomplished in late 2007 demonstrates a tax burden rising in the electrical sector. In 2002, 35.91% was due to taxes and duties. In 2005 it was 43.70% and in 2006 the tax burden within the light bill reached 46.33%.

Considering the electric power service is almost entirely universalized (over 96% of the Brazilian population are assisted by energy), the electrical sector is used to increase the government collection.

In general, there are currently 13 taxes and fees of the sector on the electric power trade[9]. The electrical community, before such uncountable acronyms referring to taxes and duties, has nicknamed them as “alphabet soup”.

GRAPHIC

As we have seen along the years, the tax burden and sectorial duties grow faster than than tariff itself. It inflates Brazil`s costs, discourages the investments in the country and reduces the national industry competitiveness. It reduces the consumers’ capacity of payment, increases the default and likewise concerns the regulatory environment.

[9] CCC, Reserva Global de Reversão (RGR), Taxa de Fiscalização de Serviços de Energia Elétrica (TFSEE), Encargo de Capacidade Emergencial (ECE), Conta de Desenvolvimento Energéticos (CDE), Contribuição ao Operador Nacional do Sistema Elétrico (ONS), Compensação Financeira pela Utilização de Recursos Hídricos (CFURH), Imposto de Renda (IR), Contribuição Social sobre Lucro Líquido (CSLL), ICMS, Imposto sobre Serviços (ISS), Contribuição Provisória sobre Movimentação Financeira (CPMF) e Cofins.

Without a reduction of taxes it will be impossible to think of moderate tariffs, and the national products will continue to lose ground for international competition. It affects directly ANEEL's mission to warrant fair electricity rates and the electrical sector regulation as a whole.

4.7 - JUDICIARY DECISIONS

The function of the Judiciary branch in regulatory concerns represents a significant challenge. It is essential for regulatory quality and a better economic performance, but there are many implications of the judicial system in terms of regulatory issues as well as for the economy.

The liberalization of economic sectors and the privatization of former state-owned companies brought new responsibilities for the judicial branch, which resulted in an increase of caseloads. The need of a reform in the judiciary system became evident, in order to make that branch more efficient and diligent. However, the judiciary system was not able to correspond to the new regulatory environment that took place.

The effectiveness of this new environment comes from the ability of the judiciary to consider regulations` consistency with principles of constitutionality and from courts`scrutiny of whether delegated legislation is fully consistent with primary legislation.

The lack of unambiguous and well-defined laws or regulation as well as the lack of appropriate regulatory milestones cause juridical instability. In addition, the Brazilian judiciary system does not correspond to population` expectations, which has resulted in the lack of public confidence.

One of the main concerns facing the judiciary is the slow processing times. It has leaded some litigants to avoid any contact with the judiciary, even if that would imply loss of opportunities and greater inefficiency.

The costs that this situation imposes on the economy as a whole can be estimated by the way the improvement in the judiciary would impact other issues: some studies states that the volume of annual investment could increase by 13.7% and the number of enterprises could grow by 18.5%[10].

Therefore, some judiciary decisions have increased the regulatory risks. Such decisions, mainly at the first instance, have been harmful to the economic growth once they increased the investor's risk perception, sharply increasing the commodities cost.

The main problem regarding this situation is the fact that some Judges and Courts of Justice ignore the existence of a regulatory framework and take decisions that go against the technical decision made by the regulatory agency. The overcoming of technical decisions has weakened the regulatory process in Brazil.

The key question is not the judicial review, but the fact that some decisions are taken without a further analyzes of their impacts in the regulatory environment and without understanding the complexity in some specific fields, such as in the energy sector.

For example, a recent report of the IDEC - Brazilian Institute for the Defense of the Consumer, said that prices have risen faster than inflation, consistently and by a significant margin, since 1999. According to that data collected, some litigants went to the judiciary branch to force a tariff review to balance the tariffs increase with the inflation.

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A tariff review, obviously, is a task that requires high technical calculation methodology and very specific studies that involve a broad variety of elements. Such technical decision has to be made by ANEEL; nevertheless, some judiciary decisions decided to protect the consumers and adjusted the tariffs to inflation. Such decisions clearly do not take into account the complexity of setting distribution companies` tariff

Besides that, a regulatory technical decision involves many specific features being supported by a different inflation methodology, which includes a deliberative strategy to rebalance tariffs to promote more cost-reflectiveness.

Another big concern is the environmental process. The country is facing huge problems in this area, what has been on of the greatest obstacles for new investments. There are environmental restrictions on most of the capacity currently under construction.

For sure, whenever an environmental agency grants a license, this license can be questioned in Court regarding the competence, the quality of the studies or others issues. In the electric field the judiciary branch bypassed some technical decision without deep analyze. Both Judges and Courts in Brazil have increased the uncertainties to the environmental permit process and therefore increased the investors' risk perception.

For example, the cost of construction of a hydroelectric plant can significantly increase during the construction of the dam, if archeological artifacts or endangered species of plants or rare animals were found in an area that was supposed to be inundated.

There are many judicial decisions that suspend the environmental licensing to build the dam for an undetermined time. It delays, for many years, an authorization for a new power facility, what results in significantly increase of investments' cost.

Many times, the Justice simply ignores the existence of several precedent environmental studies and take decisions against the technical position from the competent governmental body (regulatory and environmental), even when compulsory measures had already been imposed on the entrepreneur.

Court decisions can forbid the development of studies for new plants as it can paralyze the operation of a plant for years, even if the entrepreneur followed all the public requirements.

As we can observe, the interference of the judiciary branch in regulatory processes may affect the project budget as well. Normally, when an investor begins a project planning, he only has a little idea of how much to spend to get an environmental license and to build the plant. Investors, then, add to this estimative all the involved uncertainties (judiciary decisions) on the product cost, what definitely impacts in the overall cost of the initial Project.

The difficulties to get an environmental license and all the uncertainties around costs involved in the permit process have raised the risk and, consequently, the commodities price in Brazil.

As mentioned, when the judicial system overcomes the technical decisions without a well understanding the technical matters, the regulatory process in Brazil becomes weaken and the costs sharply increases.

SECTION 5 - CONCLUSION

The creation of regulatory agencies in Brazil has been a subject of controversy since its conception. After ten years of institutional experience, the debate about the regulatory agencies has changed focus and entered into a more mature phase.

After having overcome the first stage of regulatory agencies implementation, the challenge regulatory agencies now face is to achieve a consolidated institutional scenario as a State body and not as a governmental one; it has to reassure citizens that regulators will defend public interest and find the right balance among all existing interests.

There is a broad consensus among politicians, entrepreneurs and academics that Brazil requires changes to strengthen its regulatory framework in order to create a safe environment for investments in the country.

This paper raised some of the problems that have been faced by the regulatory authorities in Brazil, such as the interferences of other administrative bodies in regulatory issues. As it has been pointed out above, the main investors` concerns are: legal and regulatory uncertainty, the contingency procedure, the state-owned companies, the threat of a political appointed ombudsman and the management contract, the high level of taxation; the direct interference of the Federal Court of Account, and some judicial decisions.

A stable regulatory framework is essential for the success of the regulatory agencies institutional model. Therefore, without clear rules and trust, private investment will not take place. Moreover, without institutions that assure investors' confidence, Brazil will have difficulty meeting its infrastructure demand on a timely basis.

So, it is important for a good investment climate to minimize regulatory uncertainty in order to reduce investor's risk perception. If not, Brazil will continuously lose investments to other countries that are considered more accommodating.

Thereafter, the improvement of the legal and regulatory system of the country as a whole is one of the key areas to ensure sustainable economic growth and to provide a clear, comprehensive, stable and accessible environment to all stakeholders.

It seems that a broader dialogue between the regulatory agencies and the general public governance framework such as Ministers, Courts of Justice, and the Federal Court of Account, should also be improved in a way to clarify the understanding of the role and responsibilities of the regulatory agencies, including even to avoid disturbing their performance.

A better institutional design of the regulatory bodies is essential to promote and protect competition, trade, investment and supervision of capital markets in economic activity.

The achievement of such design requires that the regulatory agencies` political, management, budgetary and technical autonomy should be assured to guarantee that the agencies will work efficiently, fulfilling the mission for which they were originally created. The effectiveness of the regulatory agencies features is essential to maintain their independence.

The discussion over a standardized system for regulation-making and a regulatory review environment has started to take place. The Bill 3,337 discussed by Congress since 2004, will certainly offer significant improvement. It reflects a variety of views about the regulatory agencies` designs, management and social control.

It seems, then, a perfect moment to identify the problems and try to find out solutions in order to obtain a better regulatory framework.

Some key questions need to be raised by the stakeholders:

Do the agencies perform their role as expected? If not, what is necessary to do so?

Does society realize their importance? Does society as a whole wonder if it is possible for regulatory agencies to perform their tasks without independence?

Is it worth having an agency without effective independence?

Has the cost of an undermined agency been considered or fully understood by the society?

Do the public authorities take into account the cost of regulatory risks? Do they fully realize their responsibilities in the occurrence of such costs?

SECTION 6 - REFERENCES

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