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# **Renewal of the power generation concessions agreements under Law 12.783/2013**

**JOÃO ALFREDO S. BAETAS GONÇALVES**

**ADVISOR: LUIZ MAURER**

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## **1. INTRODUCTION**

There was plenty of expectation by the agents involved in the Brazilian electricity market about what would be the fate of the public concessions of power generation, transmission and distribution of electricity existing at the time of enactment of the Law # 8987/1995, whose deadlines would expire between mid-2015 and 2017. Most of these concessions in the energy power generation segment, equivalent to approximately 20% of installed power capacity in Brazil, consisted of state and federal-owned companies.

On the one hand, some legal scholars understood that at the end of these concession contracts the federal government should promote a bid, due to the fact that Article 175 of the Brazilian Federal Constitution of 1988 states that public services shall be granted under a bidding procedure. This first solution would be the lowest legal risk option. Others, however, defended the possibility of the renewal of the concessions contracts through the issuance of a new ordinary legislation.

To everyone's surprise, President Dilma Roussef on September 11<sup>th</sup>, 2012, issued the Provisional Measure 579/2012 ("MP 779/2012"), which turned into Law 12.783, of January 14<sup>th</sup>, 2013 ("Law # 12.783/2013"). This established the conditions for the anticipation for the renewal of the concessions, and also has introduced electric energy rate reduction through reducing some charges. The Provisional Measure 579/2012 was announced by the federal government with the purpose of enabling the reduction electricity costs to the consumers in order to increase the competitiveness of the productive sector.

The choice between the bidding procedure and the renewal of the concessions took into account not only legal aspects, but also political and regulatory. In addition, the Federal Government took into account the issue of energy security for the country. After all, the 2001 power supply crisis, known as “apagão”, showed how regulatory uncertainties can affect the investment plan of a country and the pace of economic growth (Landau, 2010).

It can be stated that Law 12.783/2013 is one of the most important regulatory frameworks in the Brazilian electricity sector, since it established a new legal regime for the renewal of the concessions, in addition to its other tariff impacts. One of the purposes pursued by the Brazilian government with the enactment of MP 579/2012 was the average 20% reduction in electricity rates across the country from the year 2013 in order to stimulate the national economy. However, not all of the power generation companies accepted the conditions that were proposed by the government to renew the concessions, resulting that the predicted average reduction of 20% in electricity rates envisioned by the government did not exceed the 16% level. In fact, some companies have decided not to renew their concessions on the terms proposed by the Federal Government, going to court to discuss the matter.

As will be seen in this paper, the Brazilian Government has decided to renew the concessions of certain projects in the electricity sector on the grounds that international experience indicated that maintaining the operation of these services by the companies would be the most appropriate way to maximize capture efficiency

and the gains provided by the amortization of assets already paid by users. In other words, the argument used by the Brazilian government was that the assets covered by MP 579/2012 had been already strongly amortized and depreciated, which could result in cheaper electricity rates for the consumers.

The purpose of this paper is to analyze the legality of the renewal of concessions for electricity generation established by Provisional Measure 579/2012. As will be seen, the new legislation set the possibility for the renewal of the contracts for a special group of electric power generation concessions. This group was formed by concessions agreements<sup>1</sup> that were granted without a prior bidding procedure and before the enactment of the Brazilian Constitution of 1988. I intend to investigate whether the renewal of concession generations has violated the concession contracts that were in full force when editing, as well as constitutional and legal principles applicable under Brazilian law.

For the objective set for this paper, an analysis of the rules applicable to public service concessions for electricity generation in the light of the Federal Constitution and the Brazilian legal system is required. Therefore, in the first section of the paper I intend to make a description of the legal regime for the generation of electricity. Then, I will explain the main characteristics indicated by the Brazilian doctrine regarding public service concessions contracts, including the possibility for an extension of the terms of such instruments. Finally, I intend to examine whether the renewal of the generation power concessions for thirty more years, along the

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<sup>1</sup> Approximately 20 concessions agreements in the generation sector; affected area of almost 20% of the installed capacity in Brazil. In transmission, it affected 9 concessions agreements, which corresponded to 85.326 kilometers of transmission lines, and in it the distribution a number of 44 contracts, which represented 35% of the market.

lines designed by Law 12.783/2013, hurt legitimate expectations of the companies involved or are in accordance with the Brazilian legal scenario.

Therefore, this article aims to answer the following questions: (i) could the renewal of the concessions could have been implemented through the issue of a Provisional Measure? (ii) what criteria should be considered to extend a public service concession? (iii) did the renewal of public service concessions for electricity generation breach legitimate expectations on the part of companies that have been achieved? (iv) does the public concessionaire have vested right to the extension of his contract even though the law changes in sequence?

## **2. LEGAL SCHEME FOR THE ELECTRICITY GENERATION IN BRAZIL**

### **2.1 Overview of the electricity generation concessions prior to 1995**

The production chain is made up of electricity generation stages, transmission, distribution and trading. The Brazilian legal system tried to regulate each phase according to the characteristics of each one of them. Since the goal of this paper is not to focus on all the legal systems of the activities of the electricity sector, for now, it is proposing an overview of the power generation activity.

It can be stated that over the past years the legal scheme applicable to the activity of power generation activity was revised as a result of the several restructurings that the Brazilian electricity sector faced.

According to article 21, section XII, b, of the Brazilian Federal Constitution, it is incumbent upon the Union to operate, directly or through

authorization, permission or concession electric power services and facilities and the energetic use of water courses in cooperation with the States where the hydroenergetic potentials are located. Also, article 176 states that utilization of the hydroelectric power can only take place with authorization or concession by the Union, in the national interest, by Brazilian citizens or companies incorporated under the laws of Brazil. In addition, Article 176, paragraph 4o, allows for the exploitation of renewable energy potential of small capacity without an authorization or grant.

As noted, the operation of services and electrical systems in Brazil requires the Union's consent, except for the potential assumption of renewable energy at reduced capacity. It is worth mentioning, however, that although the Constitution requires the State's consent for the operation of electric power services and facilities that does not mean that all activities carried out in this sector are classified as typical public services.

Over the years, the activity of electricity generation has undergone changes that reflected the review State role in infrastructure sectors. The beginning of this review process marked the 90's. In fact, it's interesting to note that by the end of the 40's private companies dominated the generation of electric energy in Brazil. Due to the inability of the private sector to sustain the growing demand for electrical power, the government began to nationalize the industry in 1945, and consolidated the investment in 1960. Later, in 70's the services for the distribution of electricity were transferred to state enterprises and public enterprises were created to invest in the generation and transmission of electric energy.

In this way, between the late 60s and 90s, the presence of the Federal Government in the electricity sector, in particular, was quite evident and even necessary given the scarcity of private resources and investments. Also, it is worth stressing that this state model has secured major investments that occurred in the 60s and 70s mainly in the power generation segment. Important state-owned companies, such as FURNAS and ELETRONORTE, were created during this time in order to generate and transmit electricity in the southeastern/midwestern and northern regions of Brazil. During this period, it became evident the option of the Brazilian Government rely on operating the hydropower source, which nowadays remains the dominant one. Nuclear, thermal and wind power supply the rest of the country's power needs. In the U.S.A, in 1920's, hydroelectric power represented about 30 percent of generating capacity and 40 percent of the energy supplied by electric systems. Today, hydro contributes only about 10 percent of the electricity produced in the U.S. or about 74,800 megawatts of generating capacity in the U.S.<sup>2</sup>.

This first period (decades 60 and 70) was also marked up by strong sector debt, which led to a settling of infrastructure accounts sector in the mid-90s, which cost the public purse of approximately \$ 28 billion (Lima and Landau, 2006). According to Maria João Pereira Rolim (Rolim, 2002), this model, marked by strong State presence, benefited from facilitating coordination, expansion and planning of the sector, and the creation of conditions for the sector financing. At the same time, it has developed a technology, promoted the socialization of access to electricity, reduced energy rates and improved the services quality.

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<sup>2</sup> FERC. <http://www.ferc.gov/industries/hydropower/gen-info/regulation/use.asp>.

In this period (before 1995), it can be said that Brazilian legislation only conceived two legal schemes for power generation: self-production and public service, with tariffs established and regulated by the Granting Authority. Both schemes existed since the approval of the Brazilian Water Code of 1934, decreed by President Getúlio Vargas (Decree 24.643, of July 10, 1934).

Article 139, paragraph 2o of The Brazilian Water Code did not require authorization or concession for the exploitations of waterfalls's hydropower less than 50kW for exclusive use by the owner. On the other hand, the industrial use of waterfalls or other hydraulic power sources should be granted under authorization or concession. Note, however, that under the aegis of the Water Code, the granting of use of hydropower energy did not require a prior bidding procedure. Concerning contract terms, the Brazilian Water Code stated that the concessions were given for a period of 30 years, with a possibility of exceptional extension respecting the maximum of 50 years, under certain conditions imposed by the Federal Government.

The decline of the purely state model occurred when the State began to show signs that would not have the financial resources necessary to ensure the expansion of the electricity sector in view of the demand that would be needed to ensure the country's economic growth for decades to come. In short, the discussion that fought around the management of state enterprises and efficiency of management and the striking inadequacy of the regulatory framework were the reasons for the beginning of the movement of structural reforms in the sector that began in the 90s (Rolim, 2002).

The restructuring of the Brazilian electric sector model was inspired by both British and American models (Rolim,2002) based on the fostering of competition in certain segments and reducing the direct State role in these segments. The objective was to allow government to focus on its role as a policy-maker and regulator, transferring the responsibility of operations and investment to the private sector (Lima, Ludimila, 2007). In fact, Brazil was following a world tendency, which is a government focused on regulation and encouraging the private investment (Oliveira, 2004).

It should be noted that this marked reduction of public framework of direct state intervention in sectors of economic activity did not produce a model that can be considered as minimal State, warns legal scholar Luis Roberto Barroso (Barroso and Landau, 2006). In this way, the State expanded its role on regulation and oversight of public services and economic activities. Therefore, it cannot be said that there was a complete power abdication by the State to interfere in the provision of public services that were being privatized. This is justified taking into account that State would have to maintain the protection of public service consumers and to ensure universal access. From then on, it started a search for alternatives in order to attract private investment to expand the electricity sector as a whole. The concept of competition is introduced in the sector, especially in the segment of trading energy, and the State role is redefined, which assumes a regulator position.

## **2.2 The new scenario for generation concessions: enactment of the Laws 8.987/95 and 9.074/95**

In this context, as a result of new concepts that began to be implemented, a number of important laws were enacted at the year of 1995 such as the Law # 8.987/95<sup>3</sup> (Public Services Concessions Law), which brought the idea of increased competitiveness to establish that the delegation of public service would be exploited for the account and risk of the dealer, through a prior public bidding.

On the other hand, it is worth mentioning the Law # 9.074/95, of 7 July 1995, which dealt with rules on grants and the electricity sector beyond the creation of the figures of the Independent Power Producer and the Free Consumers may also be highlighted as legislative frameworks of importance for the energy sector.

Also noteworthy is the enactment of Law # 9.427/1996 that created the National Electric Energy Agency - ANEEL, which became the competent authority to grant exploitation concessions of new potential of hydropower generation and to authorize the operation of thermal power projects, wind, solar and hydro qualified. In sum, ANEEL is a federal autarchy, with both final and administrative autonomy, under a special regime of operation linked to the Ministry of Mines and Energy. Alto, such agency is in charge of the regulation and inspection of the production, transmission distribution and trade of electric energy.

Between 2003 and 2004 the new guidelines and bases for the electric sector model that are still in force have been launched. This new model, outlined by the Laws # 10,847 and 10,848, both of March 15, 2004 and by Decree no. 5163 of 30 July 2004, amended relevant rules regarding electricity trading and its guidelines

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<sup>3</sup> Law #8987/95 regulated Art.175 of the Federal Constitution of 1988, which states that "it's responsibility of the Public Power to provide public services, directly, or in the form of the law grant concessions and permissions through bidding.

were launched in order to ensure greater stability, transparency and tranquility to the market. From then on, it is established two separate environments for electricity agents to carry out electricity purchases and sale transactions: The Regulated Contracting Environment (ACR) and the Free Contracting Environment – ACL. In the ACL, all electricity agents, except the distributors, would be allowed to freely negotiate power purchase agreements. In the ACR, the distribution concessionaires would purchase, at public auctions, the totality of the electricity that they have to acquire in order to meet the needs of the consumers. Under this new model, regarding the power generation sector, the power producers can either trade the energy at the ACR or the ACL. In both cases, the legal scheme applicable to the contracts is not considered public service, although there is a strong regulation on these instruments by ANEEL.

Regarding the power sector of electricity, a landmark, in fact, was the enactment of Law # 9.074/95 that tried to reshape the concessions of this activity and also created new legal schemes of activity in the sector (Shirato, 2010). As previously mentioned, one of the highlights of this law was the creation of Independent Power Producer (“Produtor Independente de Energia - PIE”) figure, behold, from then on there was the definitive removal of power generation activity of the public service scheme (Shirato, 2010), since its activity is held in private, at the entrepreneur’s own risk, without the same guarantees attributable to public service concessionaires, despite the strong regulation by the Union on such activity. Everything leads to believe that the Brazilian legislator inspired itself by the American experience by bringing the independent production of energy for the

national scenario. In the United States, the so-called independent power production was conceived as an alternative to the escalation of prices caused by the oil crisis in the 1970's (Ramalho, 2014). The main features of PIE activity came expressed in Article 11 of Law # 9.074/1995, which states the following:

Art. 11 - It's considered a power producer electric energy a corporation or companies working under a consortium that receives a concession or authorization from the grantor authority to produce electric energy for trading of all or part of the energy produced on its own risk.

The PIE can be seen as an intermediary figure between the granting of public service, dedicated to the general public, and the self-production, focused, basically, to meet its own generator's needs (Sundfeld, 2000). In introducing the concept of the Independent Power Producer, the Government intended that generation and commercialization of electric power passed to be performed by a dynamic, agile and especially competitive economic agent, producing and trading energy on his own risk and account, with prices not subjects to tariffs defined by the Grantor Authority (Nobrega, André Pepitone, 2006).

Therefore, by the enactment of Law # 9.074/95, the power generation in Brazil began to be developed under a dual legal scheme due to the fact that in one side were the older projects, conceived as public service under the Brazilian Water Code, and the new ones explored under the private system of Independent Power Production (Shirato, Vitor, 2010).

From the new legal scheme inaugurated by Law # 9,074/95, the power generation activity, depending on the project's power and the source used (hydro,

thermal, solar or wind), can be delegated to third parties through instruments such as the concession, which can be: a) the use concession or the b) concession of public service, as well as authorization. In addition to the concession and authorization there is also the figure of the record, which is applicable to smaller enterprises and with reduced generation capacity.

According to Law # 9.074/95, the scenario from 1995 was as follows: a) need for prior bid for the concession of hydroelectric plants with an output power exceeding 1,000 kW for the implementation of public service or the independent production of energy electrical; b) prior bid for the concession use related to higher hydraulic potential to 10,000 kW for the exclusive use of the self-producer; c) authorization for hydraulic potential of power between 1,000 kW and 10,000 kW intended for by self-producer. It should be noted, however, the context above was changed over the years due to successive legislative amendments. In this way, Article 26 of Law # 9.427/1996, now states the following:

(i) it is subject to authorization the use of hydraulic power potential of more than 1.000 kW and less than or equal to 30.000 kW, for independent production or self-production, maintained the characteristics of small hydropower plant;

(ii) it is subject to authorization hydraulic potential use of more than one thousand 1.000 kW and less than or equal to 50.000 kW, for the independent production or self-production, whether maintained or not characteristics of small hydropower plant; and

(iii) prior bidding procedure for use concession of public goods for hydraulic power that exceeds 50.000 kW.

We can state that the legal scheme applicable for power generation through use concession of public good agreement, celebrated with Independent Power Producers, distinguishes a lot from the scheme that applies for concessions of public services agreements. While the public service concession object is the delegation of a public service, with a predominance of collective interest, in granting use of a public good there's predominance of particular interest entrepreneur in economically exploiting the potential hydraulic. The duties imposed to concessionaires under a public service concession agreement are more serious than for the Independent Power Producers, who signs "use concessions of public goods.

With this in mind, for the purposes of this paper it is important to keep in mind that we are dealing with public concessions for generation of electric energy that were granted before the new scheme inaugurated by Law 9.074/95. It is worth noting that, nowadays, for the new concessions for electricity generation the maximum term of the contract is 35 years, calculated from its signature without the possibility of extension. This rule, in what regards to the terms of the contracts, is in effect since the issuance of the Provisional Measure 144/2003, converted into Law 10,848/2004. Examples of concessions under this situation are the hydroelectric power plants of Santo Antônio and Jirau on the Madeira River, in the Brazilian Amazon, which will have an installed capacity of 3,300 and 3,150 megawatts (MW), respectively.

### **3. MAIN CHARACTERISTICS OF PUBLIC SERVICE CONCESSION AGREEMENTS IN BRAZIL**

Initially, the relevant aspect regarding the legal regime of government contracts is that they are governed by the principles of supremacy of the public interest over the private interest and the Government's strict abidance by the public interest. Therefore, the Government, as a contracting party, has some peculiar prerogatives that cannot be questioned or challenged by the private parties (Giusti, 2003)

Public service concessions are an instrument that was designed to provide public infrastructure services that require large and expensive investments, something that was not always possible for the Government. The basic purpose of a concession is for the state to authorize someone to engage in a particular type of business activity (Brown, Ashley, 2012). In Brazil, a public service is an activity that the state, by constitutional decree, must develop for the benefit of the public. According to the Brazilian Constitution, certain activities are considered to be public services including energy, roads, railways, ports, airports, urban mass transportation, environmental services, etc. The State may provide such services directly, or through concessions. In the case of concessions, the state remains responsible for the service, which is, however, directly developed by the private sector (Brown, 2012).

It is interesting to observe that the USA model for the exploitation of the hydroelectric power plants is made by a license, different from Brazil that adopts the concession, with the establishment of concession contracts, for big hydroelectric

plants (Barcellos, Luciana, 2008). Licenses are issued for a term of between 30 to 50 years, and exemptions are granted in perpetuity. Also, license is implemented through a secondary legislation which establishes the general rules, rights and obligations and the regulator has the ability to force modifications in the conditions of the license to take into account changing conditions, but subject to statutory rules established by law (Barcellos, 2008).

In Brazil, the institute of public concessions is based on art. 175 of the Federal Constitution, which states the following:

Article 175 - It is incumbent upon the Government, as set forth by law, to provide public utility services, either directly or by concession or permission, which will always be through public bidding.

Sole paragraph. The law shall provide for:

I - the operating rules for the public service concession- or permission holding companies, the special nature of their contract and of the extension thereof, as well as the conditions of forfeiture, control and termination of the concession or permission;

II - the rights of the users;

III - tariff policy;

IV - the obligation of maintaining adequate service.

As mentioned before, the law that is referred at the sole paragraph above mentioned is Law 8987/95, as well as Law 9.094/95, which is applicable to electric energy services. On public service concession, the users of such public service, through tariffs or public price set on the contract, pay the concessionaire. The public concession contract, as well as Law# 8,987/95 and the Brazilian Consumer Defense Code establishes rights and obligations for both parties.

According to Law # 10.848, of March 15, 2004, ANEEL is competent to manage the public concession contracts of electricity services. Therefore, ANEEL is responsible for the completion of the bidding process for the concession granting and the management of their public service concession contracts. This power given to ANEEL includes the duty of surveillance, interdict and intervention, linked to the perfect execution of the contract.

While article 9, Law # 8.987/95, provides for a suitable tariff with review mechanisms to guarantee the economic-financial balance of the contract, article 6 of the same law states that the service should be appropriate, regular, continuous, efficient, safe, current, general, provided with courtesy, as well with reasonable tariffs. As scholar Brown (Brown) warns no concessionaire, however, regardless of its capabilities, will be able to operate at anything approaching optimality, without having a concession framework that provides appropriate incentives and penalties for performance and that provides symmetry between risk and reward. Therefore, that framework must include appropriate tariffs, market rules, well articulated service expectations such as quality of service standards, specifically articulated expectations in regard to externalities such as universal service and environmental requirements, and a transparent and fair regime of regulatory oversight (Brown, 2012).

The autonomy of the concessionaire to organize their project is extremely mitigated by State regulation. Therefore, the risk that the public service concessionaire assumes is much smaller than that assumed by the common

entrepreneur who has total management of their enterprise. The Granting Authority should ensure the adequacy of the service and the reasonableness of the tariffs.

Article 23, Law # 8.987/95 lists the core elements of the concession agreements. Note that in accordance with section XII of art. 23 of Law # 8987/95, it is an essential clause in the concession contract which deals with the conditions for extension of the contract. Regarding the possibility of renewal of the concession, Brown (2012) claims that the mere existence of it is very important due to the fact that it can be seen as a powerful incentive to the concessionaire not let its performance slip as the end of the concession approaches.

In accordance to Brazilian Administrative Law, public concessions contracts have a double character, since they have two types of clauses: regulatory clauses and economic clauses. Regulatory clauses are the ones related to the conditions for providing the service. On the other hand, economic clauses are the ones that preserve the economic and financial balance of the concession. For this reason, this last type of clauses is considered the immutable core of the concession contract. Thus, the concessionaire will be protected in relation to its economic expectations against a subsequent law to determine the termination of the contractual relationship. If something like that happens, the concessionaire's legitimate economic expectations shall be respected. The maintenance of the economic and financial balance is done through the reviews and tariff adjustments agreed by ANEEL.

Regulatory clauses are the ones that should contain everything that relates to the provision of the service mode. Thus it must integrate the provisions

concerning the organization and operation of the service, including the concession period and the possibility of renewal. Justen Filho (Justen Filho, 2003) explains that regulatory clauses are the ones related to: a) the performance of the contract; b) qualitative definition of the object; c) implementing conditions; d) monitoring the activity of the contractor for performance of the contract, and e) the term of the agreement, which includes the possibility of its extension and termination.

In this way, concerning regulatory clauses, the concessionaire can not discuss or negotiate its terms with the Granting Authority, and if they fail to comply they can be liable to penalties. The right to establish and unilaterally modify regulatory clauses is inherent in the Grantor. It is also interesting to note that at the time of the bid for the concession of public service, the proposal of the bidder is restricted to the economic and financial aspects. Therefore, there is no declaration of will of the applicant in the face of service conditions other than the mere submission to them. In this sense, the statutory schemes can be changed with immediate applicability of subsequent law since there is no vested right to its maintenance.

The duration of the concession contract is considered a typical regulatory clause since it is related to the conditions for the provisions of the service. Therefore, for being a regulatory clause, is susceptible to State interference through unilateral acts or even by a new legislation. Celso Antonio Bandeira de Mello (2003) emphasizes that the concession period is not an economic element of the contract, but a regulatory clause since the Grantor may, due to convenience or opportunity, terminate the concession at any time without the practice of any offense by the concessionaire. It is important to note, however, that the duration of the contract is

one of the elements that are used to determine the value of the economic and financial equation of the contract, since its linked to the amortization of the capital invested by the concessionaires and the possible profits. So, as well as other provisions concerning the provision of the service, the duration of the contract may be modified by the Grantor, extinguishing the grant before the duration initially fixed, preserving the maintenance of the economic-financial balance of the concession.

#### **4. JUSTIFICATIONS FOR THE ISSUANCE OF PROVISIONAL MEASURE 579/2012**

One of the controversial issues brought by Provisional Measure 579/2012 concerns the legislative instrument used by the Government to renewal the electricity sector concessions that would mature in the years 2015-2017. Initially, we must clarify that the extension of the concessions demanded legislative changes since the current law no longer admitted the possibility of extension. However, some legal scholars, such as Marçal Justen Filho (2003), admit no extension renewal of the concessions for exploring public utilities. For him, the government should have done a bidding procedure at the end of the electric energy concessions.

In fact, this group of concessions would begin to mature in 2015 since Law # 9.074/95 permitted the extension of their maturity date up to 20 years, calculated from July 8th, 1995, for those that were due (Lopes, Marcos José, 2013), as can be interpreted by the provision of Article 19:

Art 19. The government can renew the concessions to generate electricity

(established by Art. 42 of the Law # 8,987<sup>4</sup>) to ensure the quality of service for consumers at low cost, for a period of up to twenty years. The government could make this extension provided that the requested extension by the concessionaire, observed the provisions of Art. 25 of this Law.

§ 1 - Applications for renewal should be submitted in one year following the date of publication of this Law.

§ 2 - In cases in which the remaining term of the concession is more than one year, the request for extension should be made six months prior to the advent of their final term.

In other words, under the rules in force until then there was no more possibility of implementing an extension since all concession contracts were signed with the prediction of the maximum period provided by law.

According to the Brazilian constitutional system, in important and relevant cases the President of the Republic may adopt provisional measures with the force of law should submit them immediately to the National Congress. The instrument of the provisional measure was first established at the Federal Constitution of 1988 to replace the old ordinances. Some scholars, however, criticize the use of the provisional measure because they understand that such an instrument brings legal uncertainty in that it would be an exhaustive concentration of power in the hands of the Chief Executive.

As noted, the issuance of a provisional measure requires the relevance and the urgency of the matter. The absence of one of these two requirements may even compromise the validity of the provisional measure, according to the constitutional control system adopted in Brazil. Thus, the criticism was that the MP

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<sup>4</sup> Article 42 - The concessions to public service granted prior to the entry into force of this Act is deemed to be valid by the deadline stipulated in the contract or in the concession act as noted in the provisions of Art. 43 of this Law.

579/2012 would not have observed the requirements of relevance and urgency, taking into account the facts that led to the dispatch of such act were not new or urgent, although relevant and known a long time by the Federal Government. That is why some argued that this matter should have been the subject of ordinary law, previously discussed with other representatives of Brazilian society.

However, the reason given by the Federal Government was that the renewal of the concessions could serve lead to an accelerated and sustainable development through the overall reduction in energy costs and the increase of competitiveness of the industrial sector<sup>5</sup>. As previously mentioned, the set of measures contained in Provisional Measure 579/12 aimed to an average tariff reduction of 20%. Therefore, this government initiative was essential to increase the competitiveness of the Brazilian economy by reducing the costs of electricity.

Furthermore, it was also justified the fact that at the end of 2012, most of the energy sold under these concessions agreements would end. These contracts meet the captive market of the distributors<sup>6</sup>. The energy trading by this current mechanism, known as Existing Energy Auction, would make it difficult to capture the benefit resulting from the amortization and depreciation of assets already in 2013 and could also compromise the power supply due to the extremely short time for its realization.

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<sup>5</sup> Electricity prices are a big component of the so-called "Brazil cost", which is a mix of taxes, high interest rates, labor costs, infrastructure bottlenecks, and other issues that have caused the economy to become less competitive. After a decade of strong performance, Brazil grew below the Latin American average in year of 2011.

<sup>6</sup> According to the Brazilian system, the electric power distributors guarantee the delivery of service to their captive market by means of energy auctions held by the Ministry of Mining and Energy - MME.

For all these reasons, it seems that President Dilma Rouseff has duly observed the requirements of urgency and relevance at the time of the issuance of the Provisional Measure 579/2012.

Another argument raised by critics was that such a measure would have affronted the Federal Constitution, which prohibits the issuance of provisional measures on budget and credit<sup>7</sup>.

However, it can no be stated that such provisional measure has dealt about budgetary matters directly, although it has determined the extinction of certain charges in the electricity sector<sup>8</sup>. Despite such extinction, the Federal Government has committed itself, through the National Treasury, to make an annual contribution of R\$ 3.3 billion to partially sustain the programs funded by these charges (Lopes, Marcos José, 2013).

In fact, electrical charges such as the Fuel Consumption Account (Conta de Consumo Combustível – CCC) and the Energy Development Account (Conta de Desenvolvimento Energético – CDE) do not have a tax nature and are financed by consumers tariffs in order to support specific government policies that benefit consumers themselves. Also, these charges are managed by a semi-public corporation, which is ELETROBRAS, and are not included in the General Budget

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7 Article 62 - In important and urgent cases, the President of the Republic may adopt provisional measures with the force of law and shall submit them to the National Congress immediately.

Paragraph 1 - The issuance of provisional measures is forbidden when the matter involved:

I – deals with:

d) pluriannual plans, budgetary directives, budgets, and additional and supplementary credits, with the exception of the provision mentioned in article 167, paragraph 3.

8 MP 579/2012, converted into Law # 12.783/2013, determined the extinction of CCC, RGR and reduced the value of CDE to 25% on consumer's tariffs.

Union. Therefore, it can be stated that there was not a violation of the Federal Constitution regarding the credit and budget aspect.

Finally, it is worth noting that the Brazilian National Congress voted and approved the conversion of Provisional Measure 579/2012 into Law 12.783/2013. In addition, the Brazilian Judicial System did not declare that such legislation was unconstitutional. Therefore it is assumed that such Law is valid and in accordance with the Federal Constitution.

#### **4.1 Effects of the new legislation on public concessions of generation of electricity**

As noted, Law # 12.783.2013, regarding to the energy generation sector, had a limited impact to a group of old concessions agreements that were signed before the enactment of Law 9,074/95 and would be maturing between 2015-2017. It is worth mentioning that the model adopted by the United States for the operation of hydroelectric power plants by the private sector is less complicated compared with the Brazilian model (Barcellos, Luciana, 2008). Under the American system, when certain license finished the government may choose to operate the plant, renew the license to the company that was already operating the plant or renew the license for a new company (Barcellos, Luciana, 2008). This option does not go through a bidding process and is made by the Federal Power Commission itself.

Prior to the 1988 Constitution, the Federal Government granted electricity concessions in Brazil without a prior bid for state and federal owned

companies. There was no concern about deadlines and extensions, since state-owned companies predominantly formed the electricity sector. Actually, there were not concessions agreements, only granting Decrees. Thus, in practice, the concessionaires were responsible for promoting the use of hydroelectric energy in a region of Brazil, generally bounded by the identification of river stretches (Guimarães, 2013).

As previously mentioned in the last section, through the enactment of the Federal Constitution of 1988 the legal framework for public services has changed, taking into account art. 175 which states that concessions and public service permissions would have to be "contracted" and granted through a prior bidding procedure.

Despite the emergence of the new model introduced by Law 8987/95 and 9.074/95 it was necessary to regulate a transitional regime for the old concessions that were granted without a prior bid, but were in full operation at that time. In this sense, articles 42 and 43, Law # 8.987/95 were enacted with the purpose of restructuring the old concessions to the new constitutional requirements, especially the prior bidding and the celebration of specific agreements as it follow (Guimarães, 2013):

Art. 42 - The concessions to public service granted prior to the entry into force of this Act is deemed to be valid by the deadline stipulated in the contract or in the concession act as noted in the provisions of Art. 43 of this Law.

On the same day of the enactment of Law 8.987/95, the current President of the Republic at that time issued Provisional Measure 890/95, converted into Law

9.074/95 in order to exclude art. 42 to the electric sector concessions. Therefore, power generating concessions that were in full operation at that time and were framed under art. 42, Law # 8987/95, article 19, Law # 9.074/95 permitting a 20 year extension of concessions agreements as follows:

Art. 19. The Government, to ensure the quality of care to the appropriate cost consumers, may extend for a period of up to twenty years, the concessions of electricity-generation, reached by art. 42 Law 8987/95. The government could make this extension provided that the requested extension by the concessionaire, observed the provisions of Art. 25 of this Law.

In this scenario, on September 11th, 2012, Provisional Measure 579/2012 was published. Later on, as a supplement to the Law, Decree # 7805/2012 made the National Electric Energy Agency - ANEEL responsible for implementing the provisions of Provisional Measure 579/2012.

According to art. 1, Provisional Measure # 579/2012, the concessions for the generation of electricity described by Art. 19, Law # 9.074/95, could be renewed once at the Federal Government's discretion for a period of 30 more years with due regard to certain conditions such as: (i) remuneration under a new tariff calculated and determined by ANEEL for each power plant; (ii) allocation of quotas of the physical guarantee of the power plant to the distributors concessionaires and (iii) submission to new quality standards imposed by ANEEL. One of the most important conditions that was imposed was the participation in the so-called quota system. In sum, under such system quotas of the physical guarantee of the power plant concessions shall be allocated to electric power distributors, which would be

remunerated only for the operation & maintenance (O&M) costs, given that they would receive a compensation for the non-amortized investments made on the assets related to the public utility service provided.

The quota system prevents that the so-called “old energy”, which is cheaper, be sold on the “free market” to special consumers. The idea was that this reduction should have been transferred to consumers in general, by means of reduced electric energy rates. According to Lopes (2013):

“ (...) the basis used for the desired effect was the finding that the majority of these assets were heavily amortized and depreciated due to the operating time of approximately 30 years but in full operating conditions and with great potential to continue generating revenue for many years ahead with their respective returns on investments already fully recovered.”

#### **4.2 Arguments brought by the power generation concessionaires that decided not to renew the contracts**

The main argument raised by the concessionaires who felt harmed by the new legislation was that the concession agreements that were signed at the time of the enactment of Law # 9.074/95 expressly guaranteed them a right to a contract extension at the date of its expiration.

In fact, these contracts contained clauses, which provided the possibility of the concessionaire to apply for a 20 year extension six months before its

expiration. Therefore, these concessionaires argue that are entitled to an automatic extension of their contracts outside the conditions imposed by the new legislation. In other words, the argument brought by the concessionaires is that the new legislation breached what was expressed in their contracts regarding a supposed right to contract extension.

However, these concessionaires did not consider that the right contract extension established in accordance to Art. 19 of Law # 9,074/95, was nulled by the establishment of Provisional Measure # 579/2012, converted into Law 12.783/2013.

As previously mentioned, it was seen that the concession term is a regulatory clause since it is related to the provisions of the service. Therefore, as a regulatory clause, concessions terms are susceptible to State interference through unilateral acts or even by a new legislation.

There is a lot of discussion in Brazilian legal doctrine about the possibility of a time extension of concessions agreement. Professor Brown (Brown) supports that the tenure of concessions, both their length and the possibility of renewal is a first magnitude policy for a concession to be successful. In this way, Brown (2012) warns that, as matter of good policy, concessions should not be granted in perpetuity. According to Brown (2012), good policy suggests that concessions should be terminable, however, it is a different matter that whether a contract ought to be automatically terminated without the possibility of renewal, perhaps arbitrarily derived points in time. For Brown (2012), while it may make sense to terminate the concession of a particularly poor performer or an insolvent one, does not make sense to terminate without possibility of renewal the concession

of a company whose performance is exemplary and whose competence is amply demonstrated.

In Brazil, it is a consensus that the concessionaire does not have a “right” to the extension, since such request is discretionary and shall be first analyzed by the State under the legislation applicable. However, there is divergence among the legal scholars about the situations that authorize Grantor Authority to renew a concession. Although, it worth mentioning that the consensus is that the renewal of the concessions is an exception to the general rule of bidding and the decision should be based on legal certainty while attending the public interest (Barcellos, Luciana, 2008).

For Di Pietro (2003), the extension only is justified on exceptional situation to attend public interest reasoned or even in the event that the originally set deadline in the contract is insufficient to cover the investment, at the risk of the infinitely service maintenance in the hands of the same company, in breach of the principle of bidding.

Under article 19, Law # 9.074/95, Di Pietro (2003) understands that the law can not authorize the renewal of old contracts that made no provision about such matter. Di Pietro also supports that the decision of the renewal must be clearly motivated considering specific situation on each case.

Another Brazilian legal scholar, Marçal Justen Filho (2003), considers that a generic renewal in itself, violates the principle of equality and improperly escapes the obligation of bidding, and is therefore unconstitutional. For the author, the renewal can occur in the specific case that concessionaire’s investment is not

amortized over the period of the concession agreement. In that specific situation, the Granting Authority would have the option either to indemnify the concessionaire or extend the concession agreement by the time of capital amortization. Also, Marçal Justen Filho (2003) understands that the validity of the extension depends on the certainty of the government that the grant will ensure a certain quality of service to consumers (Barcellos, Luciana, 2008), as we can see below:

“The validity of the extension depends, therefore, on the certainty of the government that the grant will ensure quality of service to consumers. Therefore, objective data must be collected. The government must determine the amount of investment that will be made by the concessionaire, the attendance to users’ interests with lower tariffs, etc. Finally, we must ensure the concessionaire’s compliance with those same requirements as a result of bidding. Furthermore, the extension will have to ensure at least the same benefits that would be obtained through bidding.”

Brown (2012) provides an interesting point of view in regards to the potential cost to consumers, and to the economy as well, in case of an automatic termination of concession without the possibility of the renewal. For Brown (2012), the automatic termination of concessions without the possibility of renewal can cause a potential cost to consumers and to economy as a whole because there are inherent incentives of expiring concessionaires to avoid making needed investments and incurring expenses that will almost certainly lead to lower service quality. Also, according to Brown (2012), their (expiring concessionaires) economic incentive is to think about their short term profitability and loss avoidance, rather than long term

enterprise value, a very dangerous incentive to give to an infrastructure service provider. In addition, for Brown (2012) “given the risks described for both the expiring and new concessionaires, the price they will want to charge customers for their services will almost certainly be increased because they will need to access a risk premium for potential under-recovery of costs by the exiting concessionaire, and the assumption of unknowable risks (e.g. costs for the new concessionaire inherited because of underinvestment by the previous concession holder).”

Also, Brown (2012) adverts that an automatic termination of concession without the possibility of renewal makes the regulation and the enforcements of concessions much more difficult because “regulation works best when expectations of the State are fully aligned with economic incentives provided to the concessionaire.” Therefore, for Brown (2012) “when the expectations do not align well with the incentives, regulators must become more ‘hands on, meaning they need to rely more on non-economic tools such as auditing more aggressive enforcement, and heightened sensitivity to consumer complaints.”

Carmen Lúcia Antunes Rocha (1996), one of the Judges of the Brazilian Supreme Court (Supremo Tribunal Federal – STF), although recognizes the vagueness of the criteria mentioned in the legal text to be used for the extension of the concessions, believes that the legitimacy of the evaluation criteria can be found in the act of motivation by the State, which should be checked case by case. She also considers that it is possible to assess whether these criteria are designed to target the 'public interest'. Finally, the author does not reject the renewal of the concessions, nor restricts its use to cases in which there occurs the depreciation of

investments; only argues that its use should be intended to achieve the concrete public interest.

Arnold Wald (2003), in turn, believes that the extension of the concession conditions, in accordance with article. 23, XII, of Law # 8,987/95, can be validly established in the contract, and thus fully regulate the institute for the concrete case.

Despite the existence of divergence on the assumptions that lead to the renewal, the fact is that there is no doubt that the extension of the concession does not constitute a vested right of the concessionaire. Therefore, even if, in theory, the assumptions indicated in the law are presented in order to the extension of the concession, the Granting Authority will make it if deems appropriate and convenient. Therefore, there are no guarantees that the concession agreement will be renewed.

Since the duration of the concession agreement is considered one of the regulatory clauses, and, therefore, changeable unilaterally by the Granting Authority, the concessionaire can't claim any vested right in regard to the renewal of the instrument. Check below a precedent of the Brazilian Supreme Court - STF confirming the understanding that there is no clear legal right regarding the extension of a government contract since the decision falls within the discretion of the Public Administration:

“WRIT OF MANDAMUS. JUDGEMENT OF THE BRAZILIAN FEDERAL COURT OF AUDITORS, WHO HAS DETERMINED THE NON EXTENSION OF THE ADMINISTRATIVE CONTRACT. INEXISTENCE OF CLEAR AND PERFECT RIGHT. Inexistence of breach of the rights of defense. There is no clear legal right to the extension of a contract signed with the Federal Government. Existence of mere expectation of law, since the decision to extend the adjustment falls within the discretion of the

Public Administration. 2. If the legal relationship fought between the Brazilian Federal Court of Auditors and the Public Administration, there is no disrespect of the constitutional guarantees, as well as the contradictory and full defense. 3. Writ denied. (Brazilian Supreme Court – STF, Writ of Mandamus n. 26250, Judge: AYRES BRITTO, Trial Court on 02/17<sup>th</sup>/2010)

Now if the concession period can be changed unilaterally by the Granting Authority, preserving the economic and financial equation, with more reason to understand that at this point, subsequent amendments to legislative concerns immediately to the contractual relationship. Now, prevent the legislature so proceed to the argument of lack of equality imply the removal of the legislative function of the State and the possibility of opening a new legal regime. To the concessionaire, as seen, it is only guaranteed the achieve of economic and financial expectations expressed in contractual equation that, in turn, are calculated on the period stipulated in the concession agreement

Finally, it also can be stated that the extension of the duration of the concession agreement is not something automatic, since it's subject to service quality and cost criteria, as well as advantage for the collective interest.

## **5. FINAL CONCLUSIONS**

With the enactment of Provisional Measure 579/2012 the Federal Government made a decision in an effort to stimulate the economic as a whole with new and lower tariffs parameters and the extinction of some charges. Unfortunately, the effects expected did not occur, since some state owned companies did not agree with the terms that were proposed to renew their concessions agreements.

Nevertheless, it can be stated that such legislation was an important mark in the legal framework regarding the electric sector in Brazil and will be remembered in the future for further concession renewals.

As we mentioned in this paper and in my personal opinion, President Dilma Rousseff fully observed the requirements for the issuance of a provisional measure, since the matter was urgent and relevant in many aspects. On the other hand, the criticism is that such matter should have been previously discussed among other members of Brazilian society, especially ones that deal with the energy sector.

The Brazilian constitutional system allows the renewal of public concessions as long as the authority observes certain requirements. Although some legal scholars do not agree in certain issues regarding the matter, it's a consensus that the renewal shall be implemented as long it is convenient for the federal government and it does not conflict with public or community interests. In my opinion, such essential requirements were observed by ANEEL and the Federal Government in the renewal of the electric energy concessions discussed in this paper.

A concession agreement has to be analyzed or interpreted such as a typical government contract. Therefore, unlike private contracts, in government contracts there is a vertical relation in which the private party is subject to certain rules imposed by the Government and to changes in the original conditions of the contract, providing, however, the economical-financial stability agreed between the parties is maintained. In this sense, certain clauses of the contract may be unilaterally altered by the Public Administration to conform to public interest. As we mentioned, there are two species of clauses in concessions agreements: a) regulatory clauses and

b) economic clauses. The duration of the contract and the possibility of its extension or renewal is considered a regulatory clause. Therefore, such clause can be affected by state acts or new legislation without the possibility of discussion by the concessionaire.

In this way, we can state that concessionaires don't have a right that guarantee the extension or the renewal of the concession. In this sense, in my opinion, power electricity concessionaires affected by Provisional Measure 579/2012 can not claim that their concession agreements have been violated.

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