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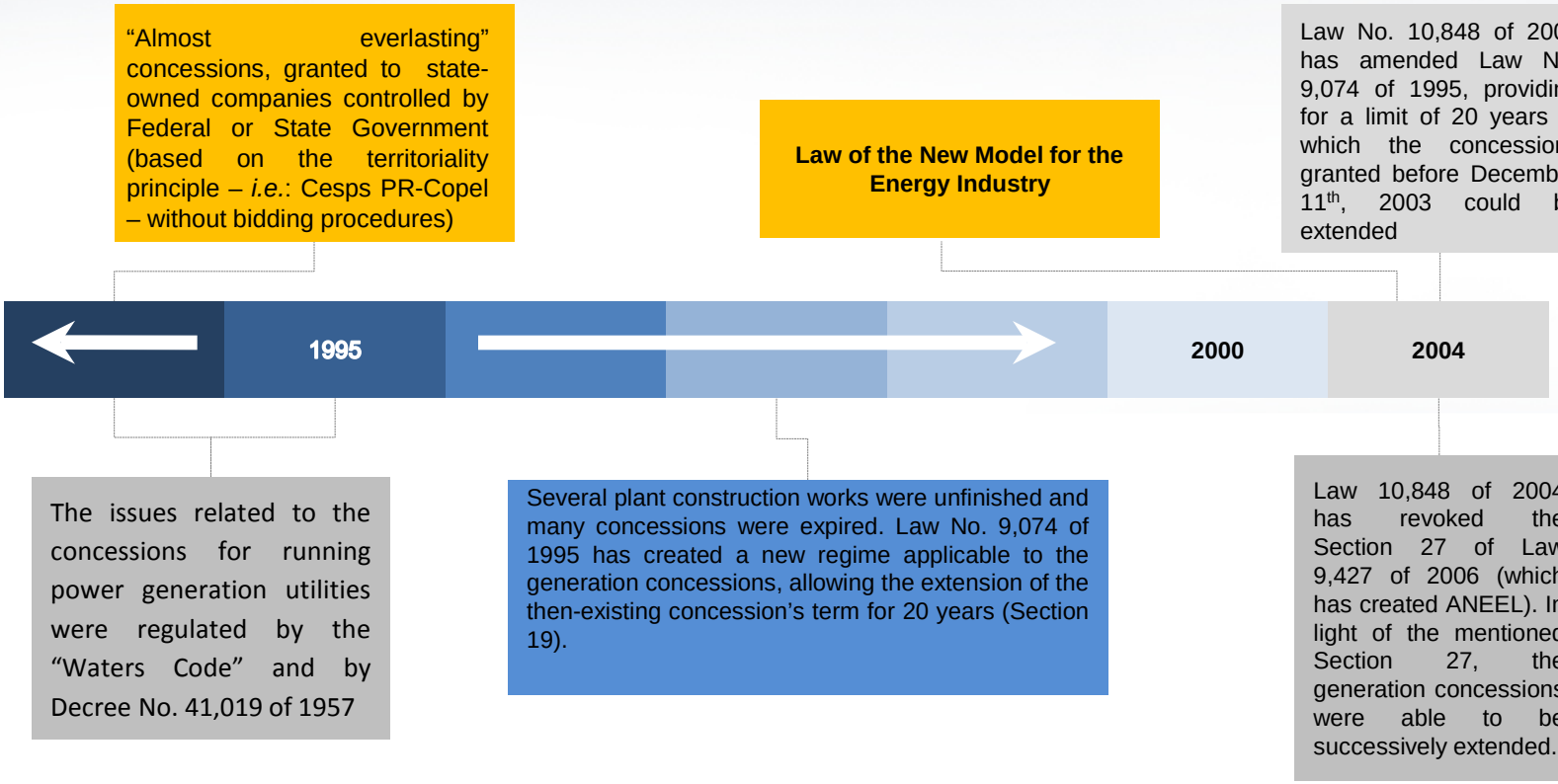
The debate around the extension of concession's term. The case of Brazilian energy industry

Estreito HPP, September 2011

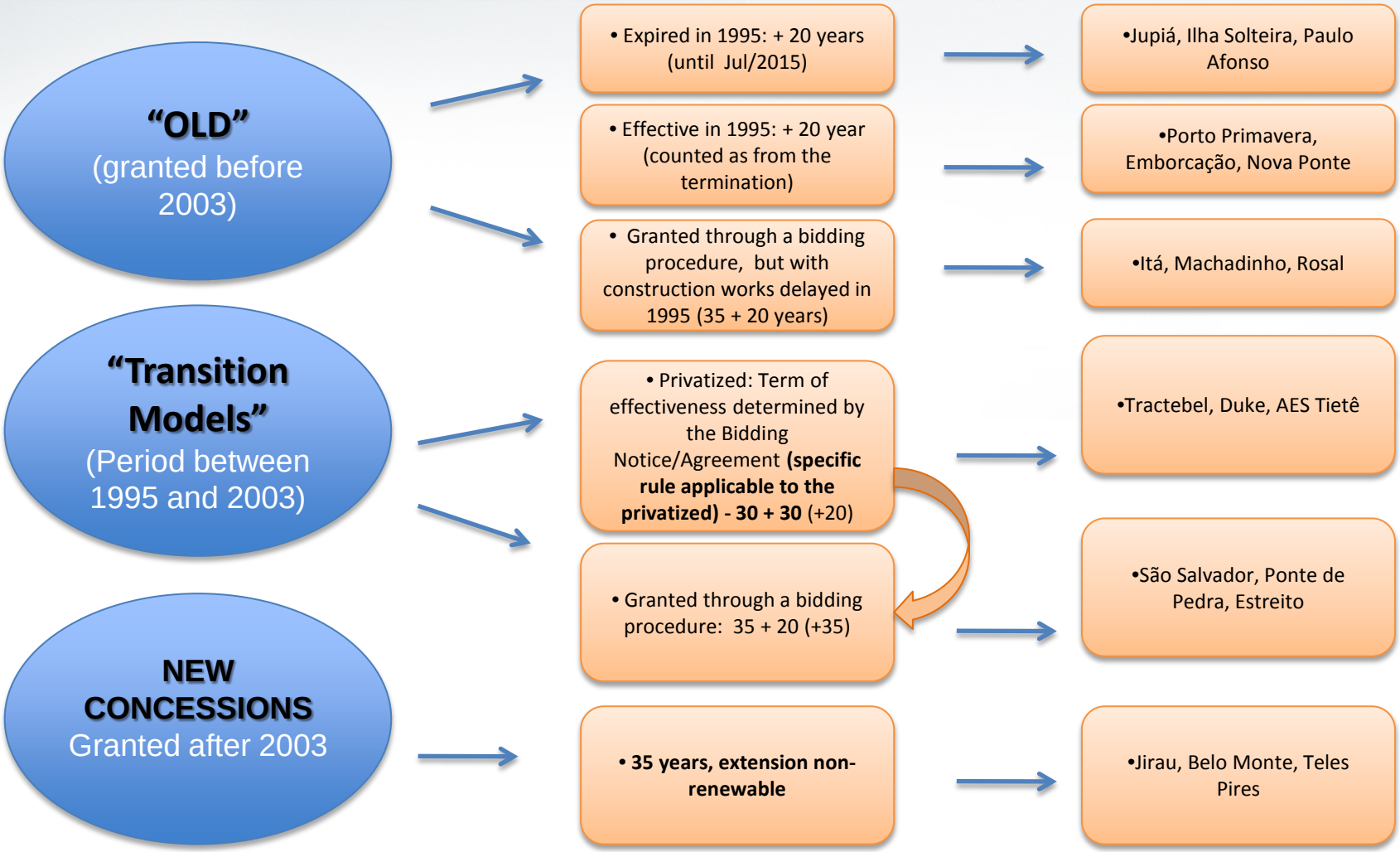
Legal and Constitutional scenario

- 1988's Federal Constitution – Article 175;
- Law No. 8,987 of 1995 – the Concessions Law – Article 42;
- Law No. 9,074 of 1995 – granting and extension of public utilities concessions and permissions – Articles 4th, paragraph 2nd, and Articles 19, 20, 21, 22, 23, 24 and 25;
- Decree No. 7,171 of 1995 – sets forth the extension proceedings applicable to the public services' concessions related to the electric energy sector, regulated by Law No. 9,074 referred above;
- DNAEE Ruling No. 91 of 1996 – establishes the procedure to apply for extension of the concession's term;
- Law No. 10,848 of 2004 – ammends Law No. 9,074 of 1995, specially in what concerns to the interpretation of its Article 4th, paragraph 2nd

Historical Perspective

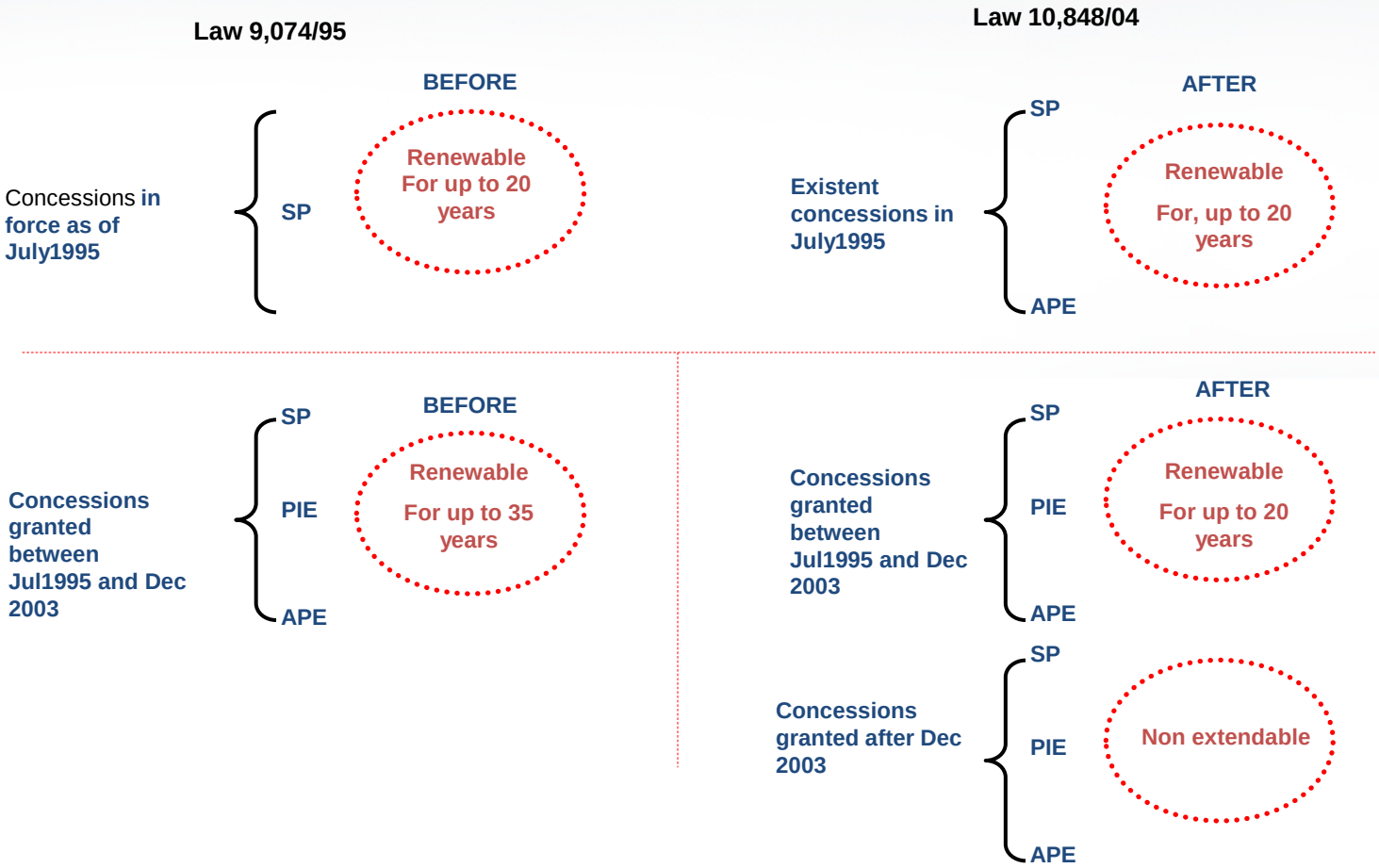


"Old" and "New" Concessions – different treatments given by the Brazilian Legislation (Laws Nos. 9,074 of 1995, and 10,848/04)



Scheme framework – What have chance with the advent of Law No. 10,848 of 2004

Changes – Law No. 10,848/2004 (Power Generation)



Universe of power generation concessions terminating as from 2015

MW	Exp.	MW	Exp.	MW	Exp.	MW	Exp.
18,227	2015	644	2021	55	2026	2,690	2030
287	2016	2,799	2023	250	2027	1,140	2032
2,144	2017	151	2024	1,750	2028	724	2033
64	2018-20	2,312	2025	1,268	2029	720	2035

Total Amount (2015-2035) = 35,225 MW

Source ANEEL: www.aneel.gov.br

- The concessions expiring in 2015** represent, approximately, 23% of the installed capacity of the Brazilian hydroelectric park;

- The total amount of 35,225 MW, related to the concessions which may terminate in the period between 2015 and 2030, represent nearly 45% of the installed capacity of the Country's hydroelectric park

**already extended concessions. The Brazilian legislation does not provide for expressly new extension

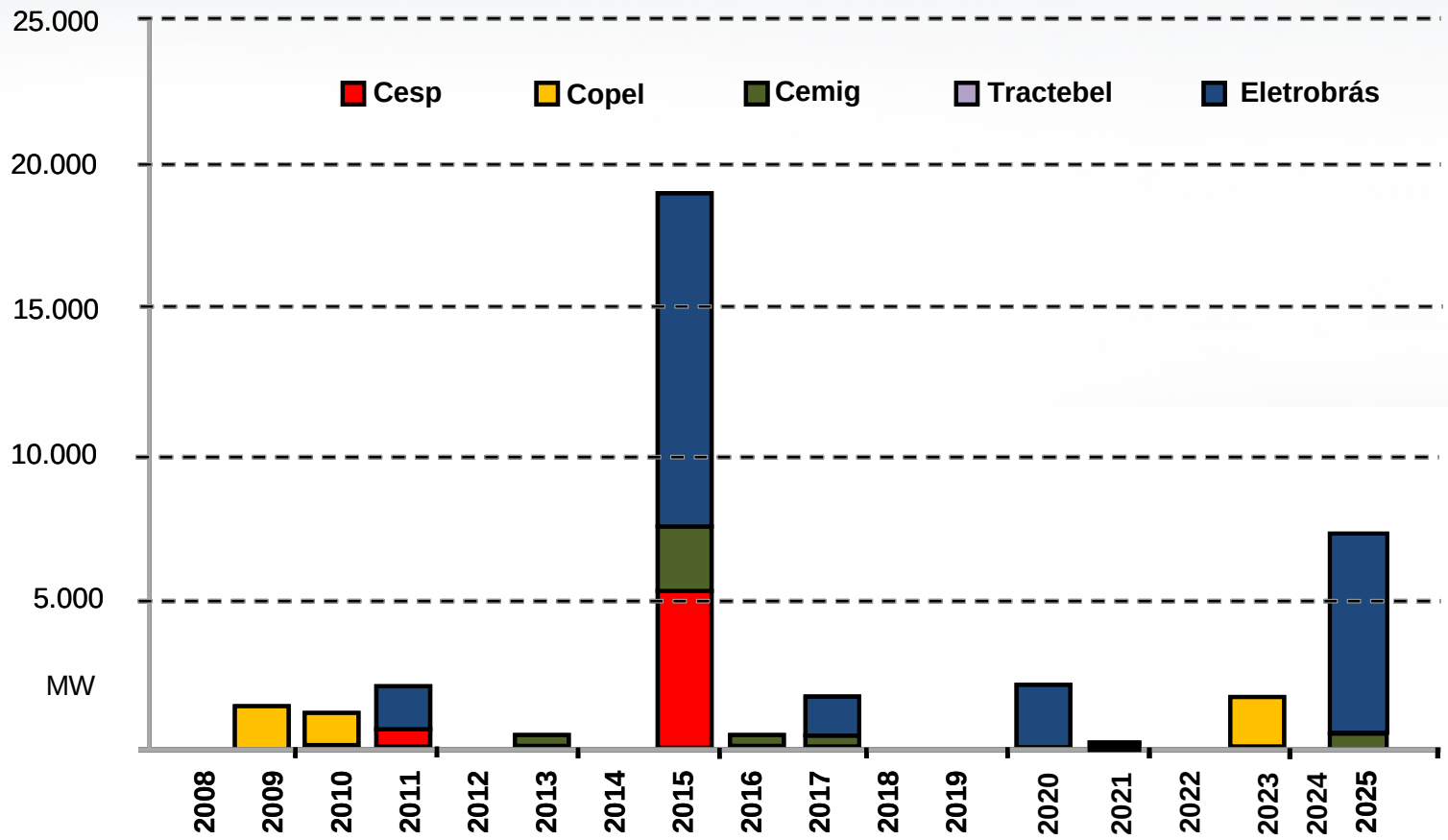
Concessions terminating as from 2015

Company	Facility	Amount (MW)
CEMIG	UHE Itutinga – 07/07/2015 UHE Salto Grande – 07/07/2015 UHE Camargos – 07/07/2015 UHE Piau – 07/07/2015 UHE Gafanhoto – 07/07/2015 UHE Três Marias – 07/07/2015 UHE Tronqueiras – 07/07/2015 UHE Peti – 07/07/2015 UHE Poquim – 07/07/2015 UHE Sumidouro – 07/07/2015 UHE Cajurú – 07/07/2015 UHE Santa Marta – 07/07/2015 UHE Martins – 07/07/2015 UHE Anil – 07/07/2015	**476.79 MW**
CESP Companhia Energética de São Paulo	UHE Ilha Solteira – 07/07/2015 UHE Jupiá – 07/07/2015	**4,995.20 MW**
Chesf Companhia Hidro Elétrica do São Francisco	UHE Funil – 07/07/2015 UHE Pedra – 07/07/2015 UHE Apolônio Sales – 10/02/2015 UHE Paulo Afonso I – 10/02/2015 UHE Paulo Afonso II – 10/02/2015 UHE Paulo Afonso III – 10/02/2015 UHE Paulo Afonso IV – 10/02/2015 UHE Xingó – 10/02/2015 UHE Luiz Gonzaga – 10/03/2015 UHE Boa Esperança – 10/10/2015 PCH Araras – 07/07/2015 PCH Piloto – 07/07/2015	**9,214.50 MW**

Concessions terminating as from 2015

Company	Facility	Amount (MW)
CEEE GERAÇÃO E TRANSMISSÃO	UHE Passo Real – 11/16/2015 UHE Canastra – 07/07/2015 UHE Bugres – 07/07/2015 PCH Ernestina – 07/07/2015 PCH Capigui – 07/07/2015 PCH Guarita – 07/07/2015 PCH Toca – 07/07/2015 UHE Jacuí – 11/16/2015 PCH Herval – 11/16/2015 PCH Santa Rosa – 11/16/2015 PCH Passo do Inferno – 11/16/2015 PCH Forquilha – 11/16/2015 PCH Juizinho – 11/16/2015	**416.50 MW**
Eletrobras CGTEE	UTE Presidente Médici – 07/07/2015 UTE Nurepa – 07/07/2015 UTE São Jerônimo – 07/07/2015	**840 MW**
COPEL	UHE Gov. Parigot de Souza – 07/07/2015 UHE Mourão I – 07/07/2015 UHE Chopim I – 07/07/2015	**261.3 MW**
FURNAS	UHE Estreito (Luiz Carlos Barreto de Carvalho) – 07/07/2015 UHE Funil – 07/07/2015 UHE Furnas – 07/07/2015 UTE Santa Cruz – 07/07/2015	**3,482.00 MW**
	TOTAL	**19,686.29 MW**

Concessions terminating after 2015



Critical Matters – Termination as from 2015

This context calls for a solution able to address the legal issues concerning the renewal of the concessions expiring as from 2015, which have already been renewed pursuant to Law No. 9,074/95

The re-tendering of the concessions which may terminate as form 2015 (and request more than 20.000 MW of the power currently generated) shall cause the following consequences:

- Loss of ability to invest in the system expansion, whether by the private sector or the state owned enterprises, which may allocate resources to re-acquire already depreciated assets
- The price of the old energy sold in the ACR by companies such as Cemig, Cesp, Furnas and Copel is only sustainable due to the "mix" of assets held by these companies (the loss of the referred assets may affect the concessions' economic and financial balance)
- The Granting Authority shall indemnify the concessionaires assets not yet depriciated (in 2015). Shall the RGR (which has expired in 2010) not be sufficient to cover the indemnifications due, resources form the Treasury will be used, or it would be necessary to transfer such resources to the new concessionaires (except for the possibility of new bidders offering lower tariffs, the pursuit of low tariffs will, certainly, be affected)

- The uncertainties regarding the "fate" of a substantial portion of the national installed capacity can contaminate the expectations of energy prices in the medium and long term resulting in wrong economic signals, either from the point of view of generation or load (including harmful reflects for the basic industry because of Country's high industrial energy needs)
- Possibility of interruption in the power services provision risk of discontinuity in the provision of essential public service
- On the other hand, there are arguments in favor of the bidding procedure, since it could attract some bidders willing to offer lower tariffs. It is important to point out that this is not a certain

Discussion concerning the possibility of a second extension or the mandatory requirement of re-tendering term

Central point of debate – Federal Constitution – Interpretation of Article 175

Article 175. The Public Administration shall render the public services, directly or by concession or permission, **always by means of a bidding procedure**, in accordance with the legislation

From the interpretation of Article 175 of the Federal Constitution, basically three trends of thinking emerge:

- **First one**: admits no extension renewal of the concessions for exploring public utilities (this would strictly attend the period required for the amortization of the planned investments). This trend is represented by Marçal Justen Filho

- **Second one:** accepts the possibility of a conditional extension – if prescribed by law, extension is allowed – procided that the concession has been awarded by means of a bidding procedure. Otherwise the legality and equality principles would be violated. In accordance with this second stream, the extension of the concession with no prior bidding procedure will only be possible with a constitutional amendment, due to the requirement expressed by Article 175, which emphasizes the bidding procedure as a condition. For delegating the provision of public utilities.

Third Trend: considers the possibility of the extension, in any event, even without prior bidding procedure, provided that there is a Law provision in this sense. Thus, a provision for extension, set forth in a specific law, would be sufficient to render another extension legal and valid. In this sense, a constitutional amendment would not be necessary. In accordance with one of the representatives of this trend, there would be a possibility of extension even without a prior legal command in this sense: a contractual provision would meet all the requirements necessary in order to allow the extension.

Possibility of providing utilities directly by the Federal Government

Interpretation of Article 42 of the Concession Law (Law No. 8,987/95) and the alteration implemented by the "Sewerage Services Law" (Law No. 11,445/07)

The public services concessions, for providing public utilities granted prior as of with this Law came into force shall be deemed valid for the term provided for by the relevant concession agreement or granting deed, and shall attend what set forth in Section 43 of this Law (see Law No 9.074, of 1995)

§ 1st: shall the mentioned term of effectiveness be terminated, the services will be rendered by a body or entity of the granting authority or may be delegated to third parties, by means of a new agreement (altered by Law No 11.445, of 2007)**. (...)

State owned enterprises (holding generation, transmission and distribution assets existent in July 2005) should be able to directly render the services of electric energy?

The new wording of Section 42 of Law No. 8,987/95 (altered by Law 11,445/07) would allow the rendering of power public services by body or entity of the relevant authority?

***Before the advent of Law No. 11,445, paragraph 1st established that: shall the concession term of effectiveness be terminated, the Competent Authority shall proceed the bidding procedure, in accordance with the legislation*

Alternatives – Construction of Article 4th, paragraph 2º of Law No. 9,074/95

Former Section 4th *The concessions, permits and licenses to supply services and electric energy facilities and use of watercourses for power generation purposes will be contracted, extended or granted under this Law and under Law 8,987 and others (...).*

Paragraph 2nd: The power generation concession, granted after the enactment of this Law, shall have the term necessary to amortize the investments ***, limited to thirty five years*** *counted as from the agreement execution date, and its term of effectiveness* ***shall be extended for no more than the same period,*** *under Public Administration's sole discretion, observing the conditions set forth in the legislation*

Current Section 4th *The concession, permits and licenses to supply services and electric energy facilities and use of watercourses for energy generation will be contracted, extended or granted under this Law and under Law 8,987 and others (...)*

Paragraph 2nd: The power generation concession, contracted ~~as form this Law~~ before December 11th, 2003, shall have a term corresponding to the period necessary to amortize the investments, limited to thirty five years counted as from the agreement execution date, and its term of effectiveness ***~~shall be extended for no more than 20 ye~~****ars ~~the same period~~* ***shall be extended for no more than 20 years****, under Public Administration's sole discretion, observing the conditions set forth in the legislation*

Exceptions – Privatized Companies

- **Section 27 to 30 of Law No. 9,074/95**

  ➢Privatization procedure in concomitance with new grant of concession, or with the extension of the existing concessions (in this hypothesis, term of the extension of all concessions shall end in the same period – limit of 30 years - Section 27, paragraph 1st):

- **Example: Tractebel Energia (1998), Duke Energy (1999), AES Tietê (1999) e CDSA (1999): had their concessions renewed for 30 years**

  ➢ Privatized distribution companies have received the same treatment (ex: Light, CPFL, Elektro, Cosern, Celpe, etc...)

  ➢ the same benefit has been granted to Copel's and Cesp's potential privatizations, in 2001 – Resolution ANEEL 375/01 and Resolution ANEEL 425/00, respectively

- **Compatibility of section 27 to 30 of Law 9,074/95 with the new model (Opinion of ANEEL's General Attorney – CTEEP's Privatization -2006)**

"As we can infer from the legal text, which systemic interpretation cannot lead us to a different understanding the extension set forth in sections 19 and 22 of Law No. 9,074/95, **do not interfere in the grant of a new concession, which can be grented in cases of privatization,** as provided by section 27 of the same Law (…) If, in light of Public Interest, the extension of CTEEP's concession have been determined, in order to ensure the quality of the services rendered to the consumers, **that does not necessarily mean that after 11 years, by the time its corporate controllers decided to privatize the concessionaire company, the adoption of the specific model elected by the governing law shall be revoked,** since it has been already adopted in other similar cases, and which constitutionality have been reinsured by the Supreme Court"

"Leading Cases"

- After the promulgation of Laws of the new model, in 2004, three relevant cases were analyzed by ANEEL, which is the agency responsible for the instruction of the concession renewal proceedings (first renewal after 1995)

  - CESP (UHEs Jupiá, Ilha Solteira, Paraibuna e Jaguari - 2004)
  - CEMIG (UHEs Emborcação e Nova Ponte e outras PCHs - 2006)
  - CESP (UHE Porto Primavera – 2008)

- Relevant manifestations and documents produced by ANEEL within the instruction of the referred concessions' extension procedures :

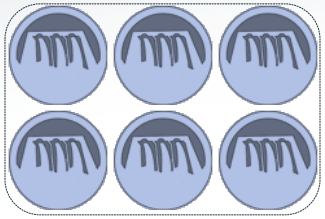
  - Technical Report (*Parecer)* Conjur/MME 313/04 – CESP 2004
  - Technical Note ANEEL 140/2004-SFF/SRE/SEM – CESP 2004
  - **"Visão Geral sobre Prorrogação de Concessões"** – CEMIG 2006
  - Votes of Directors Joísa Campanher and Edvaldo Alves Santana – CEMIG 2006
  - **Technical Note ANEEL 078/2006-SCG** (expressly mention the impossibility of renewal of concessions termination as from 2015 – Jupiá e Ilha Solteira – item 39) – CESP 2008
  - Edvaldo Alves Santana's Vote – CESP 2008

Recent Precedents

- **ANEEL Administrative Procedure No. 00000.000958/1947-65:** Reporting Director Joísa Campanher Dutra Saraiva
  - Claimant: NOVELIS (UHE Brecha) ⇒ request for concession extension, based on section 4º, paragraph 2nd of Law No. 9,074/95, amended by Law No. 10,848/04
  - Ordinance MME No. 69/04: extension of the UHE Itapuraranga concession term for additional 20 years (...) the mentioned extension was possible pursuant to paragraph 2º of section 4th, which allows the granting and the extension in favor of the Federal Government, for concessions granted before 12.11.2003, which is also the case oh UHE Brecha
  - Generation Concessions and Authorizations Superintency: *"in order to allow the term extension of the UHE Brecha grant, a concession agreement (to regulate the concession) will be necessary"* in light of section 25 of Law No. 9,074/95
  - "*It is clear that the current legislation provides for the Federal Government's faculty to extend the concessions. In this case, the Granting Authority's discretion in what relates to the term extension of the concessions is limited by the express wording of the Law (…) Considering the supremacy of the public interest over the private interest as well as the principles concerning the public administration, such decision shall be based on (…) the public interest, which shall be objectively proved*"
  - The Director has submitted the request to MME, in accordance with the capacity delegation attributed by section 3rd of Decree 1,717/95, and has recommended the term extension of concession for additional 20 years, due to the timeliness of the request and to claimant's compliance of its obligations.

- **ANEEL Administrative Procedure No. 48500.001698/2004-46:** Reporting Director Edvaldo Alves de Santana
  - Claimant: CHESF (UHE Xingó) ⇒ request for term extension of the concession from 20 years to 35 years
  - SGE: considered the original extension term for UHE Xingó (20 years) as unreasonable, since UHE has commenced to perform its commercial operation only 49 years after its granting date (1945). "*in light of the characteristics of UHE Xingó's grant, its construction historical and the commencement of the operational date, UHE Xingó's concession should receive a similar treatment as the grants extended pursuant to section 44 of Law No. 8,987/1995 and to section 20 of Law No. 9,074/1995, which received a 35 years extension*
  - Submission of the requirement to PGE: the concessionaire has not complied with the formalities required by the legislation in order to extend its grant for 35 years. PGE understood that the acceptance of the requirement would be undue
  - Director Vote: in favor of the submission of the requirement to MME's appreciation, recommending the dismissal of the request (in favor of non-extension)

Procedure



Renewal shall be requested at least 36 month prior to the concession termination

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Technical instruction of renewal request – recomendation shall be adressed to the Executive Board

MME

Decides on the approval or rejection of the renewal request – within 18 months prior to the end of the concession's term of effectiveness

Judicial, technical, economic and financial capacity, and fiscal regularity shall be proved, as per established by the applicable laws

Conclusions and main points for reflection

- Lower risk situation: new bidding procedures by the end of the term of effectiveness of the concessions: This would ensure a more restrictive interpretation of the current constitutional and legal rules
  - Considerable political risk of this alternative → counter pressure by the State and Federal Government and other political actors
  - Possibility of "Auction Theory": preference conceded to current concessionaire → potential reduction of the political risk

- Concessions' renewal → there are no insurmountable obstacles
  - More conservative approach: amendment by means of a Constitutional Amendment ("PEC") to set forth the possibility of further extension: in this sense, **the extension would be turned literally constitutional**
  - Creation of a scenario (institutional articulation, re-discussion of tariffs and investments goals with iactive participation of the stakeholders) and adoption of favorable transition rules as to allow a further extension
  - Need of a political-institutional agreement: → explanation (and actual sharing) of benefits to costumers (balance between power supply expansion and low tariffs) in order to attribute legitimacy to the agreement and avoid challenges by the controlling bodies.
  - Considering the magnitude and importance of the agreement, it is estimated that the proposal to adress the issue by the constitutional route would be voted in a short timeframe

- Renewal by means of ordinary Law → change in infraconstitutional legislation to confer legitimacy to the concessions' renewal
  - Risk: possibility of judicial debate concerning the constitutionality of the law

Thank you!

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