PUBLIC-PRIVATE PARTNERSHIPS (PPPs) AND CONCESSIONS OF PUBLIC SERVICES IN BRAZIL

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This paper examines the current regulation of public-private partnerships (PPPs) and concessions of public services in Brazil. Under the Brazilian Constitution, certain public utility services and infrastructure works must be provided or built either directly by the government or through a government franchise. Such franchise takes the form of either concessions or PPPs. The difference between the two is based on the form of government contribution. PPPs are concessions in which part or all of the concessionaire's compensation is paid by the government and does not come directly from the revenue gained through the service or work at issue. These contractual arrangements are available and actually employed throughout all government levels in Brazil. Most of the government activity in these areas in the past 20 years has adopted a concession or PPP format. By analyzing the main features of the Brazilian concession and PPP system, this paper aims to offer the international reader an introductory view of the legal framework behind most large-scale investments in Brazilian infrastructure.

Keywords: administrative law in Brazil; public services; concessions; public-private partnership (PPP); public bidding; investments; arbitration; dispute resolution.

1. Introduction[1]

The purpose of this paper is to examine the rules concerning the provision of public services, particularly through its delegation to private individuals or companies. This examination first requires previous clarification of certain premises that are particular to the Brazilian legal system.

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1.1. Administrative Law in Brazil

For a broader examination of the Brazilian notion of government and administrative law, I refer the reader to the essay 'An Overview of Brazilian Law' by Marçal Justen Filho.[2] As the author points out in his essay, administrative law in Brazil encompasses matters beyond those covered by this field in some other jurisdictions.

One of these matters of Brazilian administrative law is the provision of public services. The government in Brazil undertakes various types of economic activities under different legal arrangements. The government may compete with the private sector, for instance in the banking field. It may exploit government monopolies, such as with regard to certain aspects of oil and gas exploitation. It may pursue promotion activities, by offering financing and financial stimulus to private business. And it may be called upon to provide public services.

1.2. Public Services

Public services are certain activities that are considered – by law or directly by the Constitution – as particularly relevant to the general welfare. They are therefore subject to a specific system of rules. In the aforementioned essay, Marçal Justen Filho indicates the following:

> A public service is not to be confused with a public monopoly. The difference is in the legal system applied. The public monopoly is related to an economic activity, developed and performed under the private law legal system. Public service is an activity aimed at the satisfaction of essential collective needs, engaged under a public law legal system.

As an example, the author explains:

> Oil refining is a monopoly: it is an economic activity, subject to the rules of private law and performed by the state according to its own economic principles. Urban transportation, however, is a public service, since it is designed to attend relevant collective needs.

Since public services are defined as relating to essential public purposes, the state is required to provide them. In general terms, Art. 175 of the Brazilian Constitution states that the government is 'required, pursuant to the law, to provide public services, directly or by concession or permission, always through public bidding.' Public services are a portion of the economic activities of the state. Because of their importance, they comprise a certain selection of activities that the legal system

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[2] Marçal J. Filho, *An Overview of Brazilian Law*, in Infrastructure Law of Brazil 31–42 (Marçal J. Filho & Cesar A.G. Pereira, eds.) (3ª ed., Fórum 2012).

requires the government to provide.[3] One could say that the government *owes* a duty to society to provide public services, and society is entitled to *demand* these services. Such demands often become formal lawsuits. Health services are particularly prone to cause such societal demands, and many individual and class actions are brought against all levels of government requiring specialized health treatment not offered *sua sponte* by the state. The courts generally grant such requests and order the government to comply with its duty to offer public health services.

Under a different perspective, the legal framework that creates such governmental duty to provide public services is based on the idea of *ownership* of the service. When the legal system qualifies an activity as a public service, that activity is taken away from the market and placed under the state's ownership. This means that the activity is no longer available to be freely pursued by private enterprises unless through a franchise granted by the state. This franchise allows a private company to provide the service under government control; it does not transfer ownership of the service, nor does it waive government accountability for the service at hand.

The definition of which specific services the government has the duty to provide is the subject of great debate. In general terms, Arts. 21, 25 and 30 of the Constitution define a number of services as public, *i.e.* subject to the command of Art. 175. Those defined as federal services are provided by the Union. This is the case for certain port services, for instance. Others are defined as local (municipal) services, such as passenger transportation service within a city. Residual services are considered reserved to the states and the Federal District (Brasília, the federal capital). A typical public service attributable to the different states is passenger transportation between cities within a certain state. Telecommunications and the distribution and transmission of power are federal public services. Water and sewerage are generally considered municipal services, although there is a great deal of state-level intervention.

As it could be expected, there is great discussion concerning which aspects of those activities are necessarily public services and which should be considered simply a private activity. The regulation of telecommunications in Brazil has evolved to a point in which some activities (part of the landline services) are still public services, while others (all mobile phones communication) are a private activity, subject only to government authorization.[4]

1.3. Direct and Indirect Provision of Public Services

As mentioned above, Art. 175 of the Constitution allows the government to provide public services directly or by franchise (concession or permission). This franchise is

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[3] For a contemporary notion, *see* Juliane E. de Carvalho, *A noção contemporânea de serviço público*, 1(0) Revista de Direito Administrativo Contemporâneo 121–38 (2013).

[4] *See also* Aline L. Klein & Alan G. Troib, *Telecommunications Law of Brazil*, in Infrastructure Law of Brazil, *supra* n. 2, at 31–42.

usually referred to as a delegation of public service; specifically, the actual provision of the service is transferred to a private company (a concessionaire). But the ownership and, more importantly, the regulation of the service are kept under the government's responsibility. The private company will obtain a concession agreement for a finite period (usually ranging from 15 to 50 years, normally subject to one extension) and will carry out the activities as required under the contract. This arrangement permits the government to fulfill its duty to provide public services. That is why the concession agreement allows for a strong government intervention on the activities of the concessionaire. The government is ultimately responsible for the service and must have the means to ensure that the concessionaire will provide the service as required.

On the other hand, the concession agreement offers the concessionaire economic and financial protection against any negative effects of intervention. As Marçal Justen Filho points out in his essay, the government is entitled to unilaterally change some aspects of the agreement, but 'all these changes must come with measures intended to guarantee the original relation established between the obligations and the advantages, the so-called economic and financial balance of the contract.'

The origin of the system adopted in Brazil is the French notion of 'service public' and the related construction about the various forms of *délégation*. However, there are important differences between the Brazilian and the French systems. The idea of public service is more limited in Brazil. It also has different purposes, since in Brazil there is no administrative jurisdiction, which exists in France and in many related jurisdictions. The specific extents of the parties' rights under a concession agreement in each of these two systems are also not equivalent.

1.4. Concessions and Public-Private Partnership

The last premise to clarify is the difference between a public service concession and a public-private partnership [hereinafter PPP]. In general terms, a concession is a form of partnership between the government and the private sector. Therefore, a broad definition of PPP will encompass concessions in general.[5]

However, in 2004, Brazil enacted legislation (Law No. 11.079, or PPP Law) that distinguishes concessions (since then styled 'common concessions') from PPPs based on certain features of the contractual arrangement. The most pronounced differences relate to the nature of the activities subject to each arrangement, the form of compensation of the concessionaire and the system of guarantees. It is fair to say that Brazilian PPPs correspond generally to what in the British system is known as PFI – Private Finance Initiative. A private party will make investments and recover them by either totally or partially by receiving payment from a government entity.

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[5] 'The Brazilian public-private partnership (PPP) is a type of public service concession contract. As such, by that agreement the Government delegates to a private party the execution of an activity held by the state' (Fernão J. de Oliveira, *Public-Private Partnerships (PPP) in Brazil*, in Infrastructure Law of Brazil, *supra* n. 2, at 215).

Even before Law No. 11.079 was enacted, Brazil had amassed significant experience negotiating government concessions and franchises in the areas of transportation, toll roads, energy, telecommunication, railways and waste management. Consistent with Brazil's federation system, federal, state and local governments may all grant concessions.

These concession arrangements were – and to a great extent continue to be – modeled after the French notion of *délégations de service public*. A 'delegation concession' awarded by public tender (*i.e.* a bidding process) grants a private company (the concessionaire) the right to perform in the concessionaire's own name, for a certain number of years, a public service that the government is legally bound to offer to the public. The concession is subject to government regulation and control, including the ability to terminate the concession if the concessionaire fails to carry out the purpose of the contract. Following in the French notion of ordinary and extraordinary contractual risks, Brazil's concession system protects concessionaires against contractual changes ordered by the government or that arise out of force majeure or other circumstances beyond the control of the concessionaire. After the concession contract is terminated or comes to term, the concessionaire transfers the assets accumulated for the operation of the concession to the government, through a build-operate-transfer (BOT) arrangement.[6]

The concessionaire may charge users to access the service, or it may charge for associated projects, such as a fee to install optical fiber networks alongside toll highways. When the concessionaire receives concession revenue from sources other than the government, the arrangement is known as a *common concession*. Although this type of concession would be considered a PPP internationally as the term is understood, Brazil's 2004 PPP Law limited the concept to concessions under which the government provides all or part of the concessionaire's revenues. When all revenue is obtained from the government, the arrangement is called an *administrative concession*; when only part of the revenues are from the government, it is called a *sponsored concession*. This more limited view of PPP came about in order to address the situation in which private capital and expertise would be desirable, but the income derived by providing the service (user or installation fees) would be insufficient from a project finance point of view.[7]

Although Brazil's PPP Law has narrowed the concept of this type of partnership in one respect, it has broadened the concept in another by allowing for concessions

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[6] 'This model has the great advantage of releasing the government from payment, to the extent that the necessary resources for the construction of the enterprise are borne by the contracted company. Furthermore, the enterprise is transferred to the public officials after the term of the operation by the contracted firm had lapsed' (Rodrigo G. de Freitas Pombo, *Construction Contracts in Brazilian Law and the Standard International Model Contracts*, in Infrastructure Law of Brazil, *supra* n. 2, at 364).

[7] *See* Fernão J. de Oliveira, Parceria público-privada: aspectos de direito público econômico (Lei nº 11.079/2004) (Fórum 2007).

in fields other than public utility services, including public construction and the operation of penitentiaries, hospitals and schools. Prior to 2004, budgetary regulations required the government to have specific financial resources to fund the works, and they limited service contracts to a maximum duration of five years. The 2004 PPP Law changed this. Instead of having to allocate specific financial resources to the concession, the government can now incur debt. Therefore, new PPP arrangements can be entered into so long as the government offering the concession is able to incur new debt. What is more, concessions (PPP) can be granted for services provided in favor of the government, such as penitentiary management. Until recently, local governments had difficulty entering into PPP arrangements because they were subject to a maximum borrowing limit of 1 percent of their annual net revenue each fiscal year. In August 2009, this limit was raised to 3 percent and in 2012 it was again raised to 5 percent. This has allowed a larger number of local governments to pursue PPPs as a means to fulfill their administrative duties.

The fact that part or all of PPPs revenue comes from the government creates a risk for the concessionaire that does not occur with common concessions, which is the risk of a government default. To allay this risk, the 2004 PPP legislation created an unprecedented system of financial guarantees by forming a fund for this purpose, thereby avoiding the time-consuming process of seeking a judgment against the government and then seeking to collect on that judgment. This feature makes concession contracts governed by the 2004 Law advantageous.

These concession agreements are also advantageous in another way. Concessionaires (investors) have the ability to arbitrate under Art. 11(III) of the 2004 PPP Law. This provision calls for 'the use of private dispute resolution mechanisms, arbitration included, to be carried out in Brazil in the Portuguese language, pursuant to Law No. 9.307 of September 23, 1996, in order to solve conflicts arising from or relating to the contract.' In 2005, this provision was extended by Federal Law No. 11.196 to public-private partnerships and common concessions.[8]

Since Brazil is not a signatory of the Convention on the Settlement of Investment Disputes Between States and Nationals of Other States (the Washington Convention of 1965), these arbitrations may not be administered by the International Center for the Settlement of Investment Disputes (ICSID). However, the country has developed a strong arbitration environment and a much-acclaimed arbitration law (Federal Law No. 9.307 (1997)) that follows the framework of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention). The Superior Court of Justice, Brazil's highest court for matters applying federal law, has repeatedly confirmed the legality of using arbitration to resolve disputes involving government bodies. After

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[8] *See* Mauricio G.F. dos Santos, *Brazil – A Brief Overview of Arbitration in Contracts Entered as Part of Public and Private Sector Partnerships (PPPs)*, 21(6) Mealey's Int'l Arb. Rpt. (2006), available at <http://www.oas.org/es/sla/ddi/docs/Brasil%20-%20MEALEY%E2%80%99S%20International%20Arbitration%20Report.pdf> (accessed Jan. 28, 2015).

some hesitation, the Federal Court of Audit (Tribunal de Contas da União (TCU)), Brazil's equivalent to the US Government Accountability Office (GAO), has rendered decisions accepting arbitration for government contracts under certain conditions.[9] At the time of preparation of this article, a bill styled PL No. 7.108/2014 was under examination in Congress to permit arbitration in any type of government contract.

Notwithstanding relatively strict budgetary rules, since 2004, several state governments in Brazil have entered into concession contracts, including a project to construct a subway line in the state of São Paulo, a toll road and several penitentiaries in the state of Minas Gerais, and a sewerage system in the state of Bahia. In practice, the PPP programs of states such as Minas Gerais have so far been much greater and more comprehensive than their federal counterparts.

In the context of the preparations for the FIFA World Cup in 2014 and the Olympic Games in Rio de Janeiro in 2016, a great deal of attention has been directed toward the possibility of using PPPs to construct sports facilities. However, the 2004 statute expressly forbids using these partnerships for the mere construction of public works. The law states that PPPs must involve the provision of continuous services by the private partner, not only the construction of public facilities. Therefore, in a contract involving the construction of facilities, the PPP arrangements must point out that the private investor will operate the facility for a certain number of years. For the duration of the PPPs, the public partner (a government body) will make payments to the private investor (under an *administrative concession* or *sponsored concession* arrangement) based on the private company's performance as operator of the facility.

2. Concession of Public Services as One of Many Forms of Providing Services

Just as other jurisdictions, in Brazil private organizations provided socially relevant services before the notion of public service, with its current meaning, was coined. Until the beginning of the 1900s, private companies would obtain a temporary grant of the right to use public land or municipal property, using them to provide collective services such as railway transportation.

Under that scenario, there was no delegation of the service itself but rather a grant of the government property necessary for setting up infrastructure. The service was identified as something separate from its infrastructure only during the first half of the 1900s. Today, there is no doubt that the government 'owns' the service independently from the existence of any specific real property.

Activities relevant to society can now be carried out in Brazil under many different legal arrangements.

Some public services are offered directly by the state; others are franchised through concessions or PPPs.

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9 *See* TCU, Acórdão n° 2.145/2013-Plenário, Relator: Min. Benjamin Zymler, 14.08.2013.

Some services (health, education and pension funds) are identified as non-exclusive public services, which are public services when provided by the state, but they can also be freely (under a government authorization, but not a concession) offered by the private sector. For instance, private schools or hospitals in Brazil are not subject to a concession, but road toll companies, landline operators or bus transportation services are.

Some activities are simply private yet, subject to a government license. Mobile phone services are now under this arrangement. Many sectors, such as pharmaceuticals and banking, are completely private but undergo strong regulation and may be subject to authorization.

In sum, all different sectors have specific rules creating a variety of arrangements. In addition to one single standard format for the concession of public services (created by Law No. 8.987 in 1995), laws regulating the various sectors (oil and gas, telecommunications, electrical energy, roads, ports, transportation, water provision and sewerage, solid waste management)[10] define specific means for providing and operating services and economic opportunities in each sector.

The concession of public services is therefore only one way of providing services for the collective good. Before 1995, there was no comprehensive statute regulating public services concessions, which were governed by a combination of rules concerning different sectors. Law No. 8.987, together with Law No. 9.074, both enacted in 1995, brought about the general rules applicable to concessions, organizing a system of concessions that had been granted at various times under several different conditions.

In many sectors – electrical power generation and distribution, port terminals and bus transportation are some of them – there are still ongoing discussions concerning the adaptation of old concessions to the much more formal rules enacted after the mid-1990[s]. One of the main points of discussion concerns the need for public bidding to grant concessions. This was not widely required before the enactment of the Constitution of 1988, and it remained unregulated by statute until Law No. 8.987 was enacted in 1995. Many current concessions were originally granted without prior public bidding, and the consequences (if any) of this fact are still open to discussion in Brazil.

Law No. 9.074 of 1995 contains a list of public services that the federal government is authorized to grant by concession. Article 2 of Law No. 9.074 also requires a statutory authorization for other services to be granted by federal, state or municipal governments. The exceptions are services already referred to in the Constitution, state constitutions and municipal organization laws, as well as water provision and management of sewerage and solid waste. Many specialists consider this law

[10] Laws Nos. 9.478/1997 and 12.304/2010 (oil and gas); No. 9.427/1996 (electrical power); No. 9.472/1997 (telecommunications); Nos. 9.277/1999, 10.233/2001 and 12.815/2013 (roads, transportation and ports); No. 8.630/1993 (ports); No. 11.445/2007 (water provision and sewerage); and No. 12.305/2010 (solid waste management).

unconstitutional because it provides a waiver of formal legislative authorization for two specific types of non-federal services.

3. Features of the Concession Agreement

As mentioned above, Art. 175 of the Constitution allows for the provision of public services directly by the government or through two types of franchises, namely concession or permission. It also requires that the contractor be selected through a public bidding process.

The difference between concession and permission is merely that of stability (duration and warranties for the private company). Concessions are more stable because the services they refer to require more upfront investment. In turn, services subject to a permission arrangement are generally those that require smaller investments and therefore admit shorter durations and less compensation in the event of termination.[11]

Article 21(XI) and (XII) of the Constitution directs the Union to develop certain public services, but it mentions that such services may be developed through concessions, permissions and authorizations.

This reference to authorizations has two meanings. First, it confirms that parts of certain broad sectors (*e.g.*, energy and telecommunications) can be legally organized as private activities subject to government authorization, and not necessarily as public services. Second, it allows for the authorization of public services in some exceptional situations, such as a temporary grant for the provision of public services needed to face an emergency. Authorizations are even less stable than permissions as described above.

Regulation of a concession agreement reflects the basic premise that only the provision of the service is transferred to the private company. Ownership – comprising the regulation and ultimate responsibility for the service – remains in the hands of the state. The features of the concession reflect this balance between government prerogatives designed to enable it to carry out its duties and warranties to the private company to protect its economic rights in view of such government powers.

4. A Trilateral Legal Bond

Concession agreements are said to create a trilateral bond between the state (styled in the concession regulation as the 'Granting Authority,' since it is the public authority charged with granting the concession), the private company (the 'Concessionaire') and the users.

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[11] For a general overview about this topic, *see* Marçal J. Filho, Curso de Direito Administrativo (10ª ed., Revista dos Tribunais 2014).

It is correct to identify this as a trilateral legal bond. Even though the users are not signatories to a concession agreement, they are subject to its regulation, and they are legally granted a series of rights and duties relating to the concession. Each one of the three parties to this bond is linked to the other two through a range of duties and rights. Even if not a signatory, the users (as a category or class and, in different situations, as private individuals) can exercise rights before the granting authority or the concessionaire, and they are bound by rules that impose duties upon them.[12]

Under a concession, the concessionaire engages in a relationship directly with the user. As Law No. 8.987 says, the concessionaire acts 'on its own account and at its own risk.' This is not precise in terms of allocation of risks, since many risks remain in the hands of the granting authority. But it illustrates the fact that the concessionaire acts on its own behalf when providing services under the concession agreement. In simple terms, a user may sue directly the concessionaire for poor performance or malfeasance or for lack of adequate services; it may also sue the granting authority under partially different standing.

In a concession, the concessionaire obtains its compensation through operation of the service – in most cases, through tariffs (user fees) collected directly from the users – or of additional, ancillary or associated projects. Examples of such projects are selling advertisement spots or charging for the installation of cables along a toll road. As a general rule, a concessionaire will not receive compensation from the state (the granting authority). Payment made totally or partially by the state is a typical feature of a PPP under Brazilian law. Whether a concessionaire may receive regular payments from the state under a 'common concession' arrangement is still open to discussion.

The independent regulatory agencies created by a variety of statutes since the mid-1990s play an important part in the regulation of concessions. In some cases, they assume the role of granting authorities, carry out public biddings prior to concessions and exert government control over the concessions throughout their duration. In other cases, these agencies act as external and independent regulators and their deliberations affect both the concessionaire and the granting authority (which, in such cases, consists of a separate government body or agency).[13]

An important practical topic is the distinction between the concession of a public service, the concession to use public property and provision of services to the government. The concession to use public property allows a private individual or company to use public property (such as land) for its own benefit, not as a means to provide services to users in general. In providing services to the government, the service provider does not enter into a direct legal bond with a third party (users in general), only with the government itself. The duration of a service contract is legally

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[12] *See also* Cesar A.G. Pereira, Usuários de serviços públicos: usuários, consumidores e os aspectos econômicos dos serviços públicos (2ª ed., Saraiva 2008).

[13] An account of the subject of regulatory agencies in Brazil is found in Alexandre W. Nester, *Control of the Independent Regulatory Agencies*, in Infrastructure Law of Brazil, *supra* n. 2, at 43–53.

limited to 5 or 6 years (Art. 57 of Law No. 8.666), whereas a public service concession has a much longer duration, in many areas with no legally defined maximum duration.

5. Prior Public Bidding

Article 175 of the Constitution requires granting concessions and permissions to private companies or individuals that are selected by means of a public bidding process.

Law No. 8.666, enacted in 1993, contains the general regulation for bidding procedures. The bidding for concessions and permissions is subject to certain specific rules created by Law No. 8.987, and Law No. 8.666 applies to aspects that are not covered by Law No. 8.987.[14]

According to Art. 5 of Law No. 8.987, together with the invitation for bids, the granting authority must publish a document justifying the need for the concession. This document is an opportunity unity to publicly present an explanation based on value-for-money criteria, comparing the concession option through a private company with the provision of the service directly by the state, including a cost-benefit analysis. In Brazilian tradition, this justification has never been given specific importance, and there is no theoretical or practical construction similar to the UK's Public Sector Comparator (PSC). It is nonetheless a formal requirement of the bidding procedure. A similar requirement exists in the more recent PPP regulation (Law No. 11.079).

The general principles of Law No. 8.666 are the same: morality, transparency, equality, evaluation of bids using objective criteria and respect to the binding nature of the solicitation proposal (Art. 14 of Law No. 8.987).[15]

The first main difference is the evaluation criteria. Whereas under Law No. 8.666 there are three basic criteria (lowest cost, best technical offer and a combination of the two), Art. 15 of Law No. 8.987 offers a variety of criteria:

a) lowest tariff (user fee);

b) highest offer, in cases in which the bidding is evaluated based on the amount quoted to be paid to the granting authority in exchange for the purchase of the right to be the concessionaire;

c) best technical offer, with price previously set by the solicitation;

d) best offer based on the combination of lowest tariff and best technical offer;

e) best offer based on the combination of highest offer for the concession and best technical offer;

f) highest offer for the concession after pre-qualification of technical offers; and

g) combination, two by two, of the criteria of items 'a,' 'b' and 'f.'

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[14] For a broader and deeper view, *see* Marçal J. Filho, Teoria geral das concessões de serviço público (Dialética 2003).

[15] On this topic, *see also* Cesar A.G. Pereira, *Public Procument: General Rules*, in Infrastructure Law of Brazil, *supra* n. 2, at 103–28.

PPP Law contains yet another set of evaluation criteria, providing for combinations in which the amount of compensation payable by the government to compensate the concessionaire is one of the critearia.

Two important rules concerning the participation of state companies in biddings for concessions are in Art. 17 of Law No. 8.987 and Art. 32 of Law No. 9.074. The first orders the rejection of bids submitted by state companies that rely on financing or other advantages granted by the controlling state not available to other bidders. The second provides for preliminary contracts to be signed by state companies and third parties, *e.g.*, power plant construction contracts, in preparation for state companies' bids in concession biddings.

The general procedure is that of the sealed competitive bidding, which is the most detailed and thorough bidding method under Brazilian law. Article 18 of Law No. 8.987 sets forth the requirements for the solicitation of proposals. An important difference between the general regulation and that of concession biddings is that, under general law, the qualification phase comes necessarily first and only the offers of the qualified bidders will be evaluated. In contrast, Art. 18-A of Law No. 8.987 allows bids to open first with a post-qualification process undertaken only with regard to the winning bidder.

Another important difference is that concession bids may allow a stage of open oral bids (a normal or reverse auction). Law No. 11.079 first brought about this possibility with regard to PPPs in 2004, regulating in great detail the procedure for the offering of open bids. Shortly after that, Law No. 11.196 of 2005 included Art. 18-A, with a mere reference to 'the offering of open bids.' This is usually acknowledged as sufficient to bring about the possibility of an auction (or reverse auction) procedure into a concession bid – in which the bidders would dispute to reduce tariffs or increase financial offers for the grant of the concession. However, due to the vagueness of the statute on this point, it is a topic still open for discussion.

6. Adequate Service

Article 6 of Law No. 8.987 requires the concessionaire to provide adequate service. This is defined as service provided with regularity, in a continuous manner, with efficiency, safety, with technologically updated methods and equipment, to the public in general (with no discrimination), with consideraration and for an affordable user fee.

These general legal criteria are specified in the invitation for bids and in the concession agreement language. The agreement between the granting authority and the concessionaire will stipulate objective criteria for all such topics.

This leads to an important finding. The idea of 'adequate service' may have different criteria and definitions for the granting authority and for the concessionaire. The concessionaire enters into an agreement with the granting authority and is

required to fulfill its contractual obligations, by complying with the contractual parameters regarding adequacy of service.

However, the criteria may not be sufficient to meet the people's needs or expectations. In this case, the concessionaire will not be in breach, but the granting authority may be required to change the service regulation to meet legitimate needs and expectations to the extent deemed possible and convenient. This will be also a political, not only legal evaluation.

This raises the issue of the extent of the user's rights and obligations under the concession. Article 7 of Law No. 8.987 lists such rights and obligations without prejudice to what is provided for in the Brazilian Consumer Protection Code (Law No. 8.078).

There is a wide discussion about the applicability of the Consumer Protection Code to public services provided under concession arrangements.[16] In spite of doctrinal clarification about the differences in legal standing between consumers and public service users, courts tend to resort loosely to consumer laws when hearing cases concerning public services. But in most cases in which there exists actual conflict between the consumer regulation and the applicable public service regulation, courts tend to apply the latter. A good example is case law admitting the discontinuance of the service due to a user's failure to pay user fees.

7. Allocation of Risk and Protection of Economic and Financial Balance

Many will say that a concession agreement is all about allocation of risks. This statement seems accurate to a great extent. There are many risks involved in the long-term provision of public services, and the statutory regulation and the concession agreement at hand deal with the allocation of such risks among the concessionaire, the granting authority, the users and the general budget (*i.e.* the taxpayers).

For the limited purposes of this introductory essay, suffice it to focus on the main aspect of the allocation of risks. Under the concession law, the granting authority is given the prerogative to unilaterally change the conditions under which the service must be provided. As noted in the the discussion above, if the granting authority finds that the service being provided, albeit compliant with the contractual parameters, is insufficient to satisfy the public's needs, it is entitled to change such parameters. It may – within reason and in a justified and procedurally sound manner – require additional equipment or more personnel. And the concessionaire is required to comply with any such new requirements.

Compensation for unilateral change provides the concessionaire with absolute protection of the economic and financial balance between burdens and benefits in the concession. Upon submission of the ultimately winning bid, there is the formation

[16] *See* Cesar A.G. Pereira, *Direitos dos usuários de serviços públicos*, 2009(34) Informativo (*Justen, Pereira, Oliveira & Talamini*), available at <http://www.justen.com.br/informativo.php?l=pt&informativo=34&artigo=936> (accessed Jan. 28, 2015).

of a theoretical equation, with all positive items on one site (tariff income, associated projects income, other payments from different sources) and all negative ones on the other one (investment and current costs, other liabilities).[17] This equation is generally reflected in economic terms such as internal revenue rates or present net worth and is generally the basis for the ongoing assessment of the concession equilibrium.

Therefore, if the granting authority decides to change parameters in a way that increases costs, it will be required to simultaneously compensate the concessionaire in order to maintain the initial equilibrium.

This system is regulated by Art. 9(2), (3) and (4), and Art. 10 of Law No. 8.987:

> Article 9
>
> <. . .>
>
> § 2. The contracts may provide for mechanisms of revision of the tariffs, in order to maintain the economic and financial balance.
>
> § 3. Except for the income taxes, the creation, modification or extinguishing of any tributes or legal obligations, after the presentation of the offer, when its impact is proven, shall imply the revision of the tariff, for more or less, according to the case.
>
> § 4. In the case of unilateral modification of the contract that affects its initial economic and financial balance, the granting authority must reestablish it, concomitantly to the modification.
>
> Article 10
>
> Whenever the conditions of the contract are complied with, its economic and financial balance is considered maintained.

A good example of this regulation is that of the possible creation of supervening tariff exemptions by the granting authority. Article 35 of Law No. 9.074 requires the granting authority to simultaneously have 'the provision, in law, of the source of funds or of the simultaneous change in the tariff schedule of the concessionaire or licensee, so as to preserve the economic and financial balance of the contract.' This rule has been actually invoked with success by bus transportation service concessionaires to challenge a law providing for tariff exemptions for senior citizens without compensation for the service providers.

The same reasoning applies to risks linked to circumstances beyond the control of the concessionaire, such as acts of God, *force majeure* or general economic distress. The provision of Art. 2(II), (III) and (IV) of Law No. 8.987 ('on its own account and at its own risk') is not to be read literally. It refers to what is known as *ordinary risk*, or the

[17] 'In order to protect the private contractors from such events, there is the guarantee of the maintenance of the contractual economic-financial balance. The guarantee concerns the relation between obligations and benefits that are established when the contract is signed' (Aline L. Klein et al., *Government Contracts in Brazilian Law*, in Infrastructure Law of Brazil, *supra* n. 2, at 195).

normal risk of the business undertaken by the concessionaire. It is recommended that the concession agreement be clear about the allocation of risks. But in any case, the *extraordinary risk* is placed in the hands of the granting authority. Such extraordinary risk corresponds, in general terms, to (i) the risk of contractual breach by the granting authority; (ii) the risk of change of generally applicable rules – the typical case is the creation of new taxes, charges or regulatory requirements; and (iii) the risk relating to unforeseeable or uncontrollable circumstances, such as acts of God, *force majeure* or extraordinary economic changes.

An interesting example occurred in January 1999 when the Brazilian government abruptly changed its currency exchange policy, causing a sudden and significant rise in exchange rates. Most court decisions recognized this as a cost attributable to an extraordinary risk and ordered adequate compensations to government contractors.

It is important to point out that the restoration of economic and financial balance is due when the supervening facts cause an increase or a decrease in the concessionaire's burdens or benefits. Therefore, it is possible for the granting authority to apply an increase in the concessionaire's burdens as compensation for a supervening unforeseen advantage that was not included in the ordinary risk in the underlying agreement. Again, a reduction in tax costs is a clear example.

Due to Brazil's long experience with inflation up to the 1990[5], all government contract regulations (including concessions) provide for predefined criteria for readjustment of tariffs (user fees) as a means to protect against inflation. Article 9 provides for readjustment, as well as for the revision of tariffs due to the breach of economic and financial balance. Such revision is generally defined in concession agreements as either ordinary – normally every five years – and extraordinary – whenever a reason for revision arises. Ordinary revisions are generally considered more flexible and not too strictly attached to the criteria of extraordinary revision based on an unforeseen event falling under the concession's extraordinary risk.

Evidently, as concessions become less monopolistic and more competitive and commonplace in a market environment, economic and financial balance (*i.e.* the allocation of risks) becomes more dynamic and less strict. The lesser the governmental control over the concessionaire's activities and investments, the larger the freedom of action for the concessionaire and the lesser the guarantee related to the contractual balance.

Put another way, more flexible governmental control leads to a greater assumption of risk by the concessionaire. As a consequence, the concept of protection of economic and financial balance or equilibrium has a smaller field of application. The concept is still the same, but the area of extraordinary risk is reduced.

8. Compensation of the Concessionaire

In a common concession (as opposed to sponsored and administrative concessions, the two existing formats of PPPs), the most important source of income

for the concessionaire is the tariff or user fee. According to Art. 9 of Law No. 8.987, the tariff is set by the amount offered in the winning bid – if not previously defined by the solicitation – and protected against inflation by readjustment (escalation) rules that must be provided for in the agreement.

One of the aspects of adequate service, as seen above, is its continuity, meaning that it is not to be interrupted. But Art. 6(3)(II) allows for the discontinuation of the service if the users breach their obligation to pay tariffs. There are frequent legal discussions about the possibility of discontinuation of essential services (*e.g.*, water and power), and the courts tend to allow concessionaires to discontinue most services due to user default. Only in exceptional circumstances will the concessionaire be required to maintain the services in spite of the user default, in which case the concessionaire will be entitled to compensation from the granting authority.

Before the enactment of Law No. 11.079 and the creation of PPPs, there was little objection to the possibility of, in lieu of or in addition to tariffs, the granting authority making payments to the concessionaire as compensation. This was viewed also as a means to make the tariffs more affordable to the user, fulfilling the concept of adequate service. Since this is specifically the purpose of a PPP (sponsored or administrative concessions, with payments made partly or totally by the state), many scholars believe that such payments are now improper in common concessions. The reason for that lies in the fiscal responsibility requirements created by Law No. 11.079 as a condition for such payments from public funds, which would be dodged if similar payments could be made in a common concession.[18] However, the general tendency favors the possibility of government subsidies or payments under various formats even in common concessions.

A frequent discussion concerning tariffs relates to the possibility of collection of tariffs for services that have no free counterpart available to the user. This discussion started with road tolls created in highways that were the only possible way to reach a certain destination. Articles 7(III) and 9(1) of Law No. 8.987, as amended in 1998, state clearly that a choice between a free service and a paid service is not mandatory and that only a statute may subject the collection of tariffs to the existence of a free alternative service. This is the orientation generally adopted by courts as well.

It is widely recognized that tariffs may have a social or promotional purpose. It is common for granting authorities to set minimum levels of service to be provided free of charge and to set social tariffs at subsidized amounts for low income populations. This is usually done by means of cross-subsidies internally to the concession's tariff schedule, but there are statutory authorizations for government subsidies in these cases. The idea behind the PPP is precisely to allow concession-format contracts in areas in which the mere exploitation of the service by the concessionaire would not be financially viable.

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[18] For additional discussion on this issue, *see also* Cesar A.G. Pereira, *O processo licitatório das parcerias público-privadas (PPP) na Lei 11.079/2004*, in Parcerias público-privadas: um enfoque multidisciplinar 193–234 (Eduardo Talamini & Monica S. Justen, eds.) (Revista dos Tribunais 2005).

Article 11 of Law No. 8.987 addresses the issue of income from additional, ancillary or associated projects. This topic raises many questions, since it involves an advantage to the concessionaire but also a means to permit greater affordability of tariffs. Difficulties arise from the need to create economic incentives to the concessionaire and from the fact that such associated activities are not public services in the legal sense, but private activities, *e.g.*, advertisement in the vicinity of highways.

One last topic with regard to tariffs is their role as 'receivables' in concession finance arrangements. Articles 28 and 28-A create a detailed regulation of the assignment of income as collateral in financing agreements. Article 28 allows for the assignment of tariff income 'up to the limit that does not compromise the execution and continuity of the service.' More recent changes have also modified a crucial limitation that existed in the original regulation, and they have allowed the government agency to make advance payments to facilitate initial works in a PPP.[19]

9. Reversible Assets

The assets involved in the provision of public services are subject to a special regulation and are expected to become public property at the end of the duration of a concession.

The regular duration of a concession should allow for the amortization of all investments, so that at the end of the contract the state should receive the assets at no additional cost.

However, this is not true in most cases. There is a detailed regulation concerning the situation of reversible assets at the end of a concession, precisely due to the various problems that usually take place when a concession is approaching its end.

10. Termination of Concession

A concession may end for a variety of reasons. One is the mere end of its duration (term). But it may also end due to redemption (early termination for reasons of public interest), forfeiture (breach of the contract by the concessionaire), rescission (breach of the contract by the granting authority, recognized by a court ruling) or annulment (in view of a violation of the law). Other less common occurrences are addressed in Art. 38(1)(VI) as follows: bankruptcy, extinction of the concessionaire as a legal person, loss of civil capacity, agreement to terminate, disappearance of the service and *force majeure*.

Article 35 of Law No. 8.987 regulates the end of a concession. In all cases, the granting authority is responsible for compensating the concessionaire for reversible assets not yet fully amortized. The difference is that in the cases of end of duration and

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[19] *See* Rafael W. Schwind, *Alterações na Lei das parcerias público-privadas pela Lei nº 12.766*, 2013(71) Informativo (*Justen, Pereira, Oliveira & Talamini*), available at <http://www.justen.com.br/informativo.php?&informativo=71&artigo=898> (accessed Jan. 28, 2015).

redemption, compensation must be made prior to the takeover of the concession by the granting authority. When a concession ends in forfeiture, previous compensation is not a condition for the takeover (Art. 38(4) of Law No. 8.987).

11. Arbitration

Article 23-A of Law No. 8.987, inserted by an amendment of 2005, expressly provides for arbitration as a means of dispute resolution between concessionaire and granting authority.[20] Arbitration must take place in Brazil and be conducted in Portuguese, but it may be administered either by a Brazilian arbitration center or by an international institution, such as ICDR or ICC. There are many arbitral institutions with experience in PPPs and concession contracts, such as CAMFIEP (Câmara de Arbitragem e Mediação da Federação das Indústrias do Estado do Paraná (Chamber of Arbitration and Mediation of the Federation of Industries of the State of Parana)) in the state of Parana, CAMARB (Câmara de Arbitragem Empresarial – Brasil (Commercial Arbitration Chamber of Brazil)) in the state of Minas Gerais and CAM-CCBC (Center for Arbitration and Mediation of the Chamber of Commerce Brazil – Canada) in the state of São Paulo. CAM-CCBC is also frequently chosen as arbitral institution in PPP and concession contracts made by the federal government. Generally, the government agency in charge of the bidding process will choose the arbitral institution at its discretion, normally by including a pre-dispute settlement clause (arbitration clause) as part of the bidding documents (RFP – Request for Proposals, solicitation or invitation to bid) for the PPP or concession. However, Brazilian case law also admits that the government agency and the private party enter into a post-dispute submission agreement even in the absence of an arbitration clause in the bidding documents.[21]

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[20] A variety of topics concerning arbitration and state parties are found in a book Eduardo Talamini and I have edited and written for: Arbitragem e poder público (Cesar A.G. Pereira & Eduardo Talamini, eds.) (Saraiva 2010).

[21] STJ, REsp No. 904.813/PR, Relatores: Min. Nancy Andrighi, Terceira Turma, 20.10.2011, DJe 28.02.2012.

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