

PPP PROJECTS IN BRAZIL: OPPORTUNITIES AND CHALLENGES FOR THE CONSTRUCTION AND ENGINEERING INDUSTRIES

Júlio César Bueno

Pinheiro Neto Advogados, Brazil - São Paulo
Ph.D USP, LL.M Cantab

(+55 11 8214 7443 | +55 11 3247 8667 | jbueno@pn.com.br)

Over the last decades governments have been struggling to achieve economic development and competitiveness through improving their basic infrastructure. Increasingly governments are turning to the private sector for the financing, design, construction and operation of infrastructure projects. Once rare and limited, these public-private partnerships (PPPs) have emerged as an important tool for improving economic competitiveness and infrastructure services.

Brazilian PPP Law defines PPP as “Public-Private Partnership is an administrative concession contract that may assume the form of either a sponsored or an administrative concession contract.” PPPs are expected to be implemented concurrently with existing concession contracts, focusing on infrastructure projects. PPP Law provides for sponsored concession and administrative concession and applies to government entities (including mixed-capital companies) directly or indirectly controlled by the Federal Government, States, Federal District and Municipalities.

There are various types of PPPs, established for different reasons, across a wide range of market segments, reflecting the different needs of governments for infrastructure services. A strong PPP allocates the tasks, obligations, and risks among the public and private partners in an optimal way. The public partners in a PPP are government entities, including ministries, departments, municipalities, or state-owned enterprises. The private partners can be local or international and may include businesses or investors with technical or financial expertise relevant to the project. The structure of the partnership should be designed to allocate risks to the partners who are best able to manage those risks and thus minimize costs while improving performance

Contents

1	INTRODUCTION	2
1.1	Defining PPPs	2
1.2	Historical background of the PPP Law in Brazil	3
2	PPPS IN BRAZIL	4
2.1	General concepts and guidelines	4
2.2	PPPs and concessions	5
2.3	Types of PPPs	6
2.4	Tendering process	6
2.5	Some mandatory clauses are required in PPP contracts	8
2.6	The role of guarantees in PPPs	9
2.7	The division of extraordinary risks in PPPs	12
2.8	The legal limitation and the consideration of the public administration	15
2.9	Financing limitation and the resources from the public sector	16
3	CONCLUSION	17
3.1	A pragmatic approach is needed	17
3.2	International trends and lessons learned	18
3.3	A view on the future	19
3.4	Final remarks	21
4	REFERENCE	22
5	LEGISLATION - ENGLISH VERSION OF THE PPP LAW	1

1 INTRODUCTION

1.1 Defining PPPs

The term “public–private partnership” describes a range of possible relationships among public and private entities in the context of infrastructure and other services. Firstly introduced in the Anglo-Saxon world countries (*e.g.* United Kingdom, Australia and South Africa) public-private partnerships (PPPs) - or the so called private finance initiatives (PFIs) - are now a widespread concept in many countries.

PPPs can be described as contracts by which public and private sectors undertake the provision of services or public works, sharing risks and with funds obtained by the private sector. They operate as a new strategy for financing infrastructure in face of scarce financial resources and benefiting from the management efficiency of the private sector.

The main characteristic of a PPP project, compared with the traditional approach to the provision of infrastructure, is that it bundles investment and service provision in a single long term contract. For the duration of the contract, which can be as long as twenty or thirty years, the concessionaire will manage and control the assets, usually in exchange for user fees, which are its compensation for the investment and other costs. At the end of the franchise, the project reverts to government ownership.

PPPs are certainly suitable to large-sized works and utility services projects in which the private sector assumes responsibility for design, construction, financing, operation and maintenance of significant assets, and whereas the public administration acts as a client responsible for payment of the services provided. Sectors in which PPPs have been completed worldwide include:

- (a) air traffic control;
- (b) airports;
- (c) bridges;
- (d) hospitals;
- (e) housing;
- (f) pipelines;
- (g) power generation and distribution;
- (h) prisons;
- (i) railways;
- (j) refuse disposal;
- (k) roads;

10^a Conferência Internacional da LARES - “PPP projects in Brazil: Opportunities and challenges for the construction and engineering industries” (Júlio César Bueno).

- (l) school buildings and teaching facilities;
- (m) seaports;
- (n) stadiums; and
- (o) water and sanitation.

1.2 Historical background of the PPP Law in Brazil

One of the significant steps for PPP implementation is the development of a legal framework that becomes attractive to investments without damaging governmental functions in defence of public interests. Such adequacy of legal context is a complex process. Common Law countries allow flexibility in contract rules that Public Administration celebrates with private sector. In countries that had followed Civil Law tradition and had adopted the French Administrative Law (*e.g.* Argentina, Brazil, Chile, France, Portugal and Spain), the situation is quite different. The interventionist State character, able to exceed in contractual relations to defend the public interest, is transparent in its detailed and peculiar Administrative Law. At the same time, this excessive rigor limits negotiation with private sector: principles of public morality, isonomy, and transparency that monitor all public actions, make difficult preserve commercial secrets even in irrelevant details for the public interest.

In Brazil the path to PPPs was construed through the enactment of the Federal Law No. 11,079, 2004 (the PPP Law) that instituted the general rules for bidding and contracting PPPs within the realm of public administration. This is an important volley in the Brazilian government efforts to develop funding and management alternatives for public works in furtherance of the bidding system instituted by the Federal Law No. 8,666, 1993 (the General Administrative Contracts Act) and to reduce the state presence in the Brazilian economy.

PPPs represents an indispensable alternative for economic growth in view of Brazil's critical needs on the social and economic fronts, to be addressed by a positive cooperation between the public and private sectors. The driving force behind the adoption of PPP concept was the well-known critical shortage of public funds to sponsor infrastructure works and utility services and to meet the demand resulting from the country's announced economic growth spurt. This shortage of public funds, coupled with the private sector's lack of interest in taking over such works and services under the traditional concession system, may help explain why infrastructure investments have come to a near halt.

Several important and controversial issues were discussed during the adoption of the PPP Law, such as:

- (a) bidding procedures; the origin of public funds to make up the Public-Private Partnership Guarantee Fund under Article 16 of PPP Law;
- (b) the priority given to settlement of financial obligations under PPPs;
- (c) the role of Special Purpose Companies in the venture;

- (d) the limitations imposed by the Federal Law No. 101, 2000 (the Fiscal Responsibility Law); and
- (e) the possibility of adopting arbitration as an alternative dispute resolution mechanism for PPPs.

The introduction of legal mechanisms of such a magnitude conceivably arouses a number of doubts and questions. However, offered a wide array of possibilities for the presence of private concerns in key sectors of the Brazilian economy, the reason why the great expectations and discussions over the role of PPPs in Brazil are far justifiable. In fact, according to data published by the Ministry of Planning, Budget and Management, based on the Government's Multiyear Plan, it has been estimated that investments equalling 21.7% of Brazil's Gross Domestic Product will be required to resume and sustain the country's economic growth.

The studies conducted to prepare the Government's Multiyear Plan, which is aimed at resuming economic growth and has as its greatest challenge to expand investments and exports without hindering the commitment of increasing domestic consumption, evidence the Government's need of tools that can help it overcome the obstacles to economic growth. To achieve its purpose, the Federal Government prepared a portfolio containing projects that should be developed with the participation of the private sector. Investments needs were estimated at approximately hundreds of billions of US Dollars in the transportation (railways, highways and ports), irrigation and water resources areas in the country's five major regions.

2 PPPS IN BRAZIL

2.1 General concepts and guidelines

PPPs operate as an arrangement between the public and private sectors for execution of works originally entrusted to public concerns, which lack funds and/or expertise. PPP should than be understood as an institutional and contractual partnership arrangement between government and a private sector operator to deliver a good or service to the public, with as distinctive elements:

- (a) a true partnership relationship; and
- (b) a sufficient amount of risk transfer to the private operator.

Nevertheless, in many countries PPPs were implemented by governments who did not properly understand the nature of those partnerships. A lack of understanding can lead to the failure of individual projects and a tarnished reputation for the PPP concept. Fallacies on the nature of PPPs still abound and many times they are rooted in ideological biases, other times in ignorance. Some confusion surrounds the definition of PPPs and at times they are confused with concession, privatisation and at other times with subsidisation or public regulation. The spectrum of different forms of a relationship between government and the private sector can be broad and therefore, for policy purposes PPPs should be than clearly defined.

Article 2 of the PPP Law defines PPP as “a concession contract, in the sponsored or administrative forms” and applies to all government entities (including mixed-capital

10^a Conferência Internacional da LARES - “PPP projects in Brazil: Opportunities and challenges for the construction and engineering industries” (Júlio César Bueno).

companies) directly or indirectly controlled by the Federal Government, States, Federal District and Municipalities. Reflecting a general concern about the manner in which PPPs are to be conducted, the PPP Law also lays down the following guidelines:

- (a) efficiency in complying with the State's missions and in using the company's funds (due care in the use of the public funds invested in the activity);
- (b) respect to the interests and rights of service users and of the private entities charged with performing the services;
- (c) non-transferability of regulatory and jurisdictional duties, the exercise of police power and other activities inherent to the State;
- (d) fiscal responsibility in the execution and performance of partnerships, as Article 10, I(b) of the PPP Law stipulates that the rules set out in Fiscal Responsibility Law must be observed;
- (e) transparency in procedures and decisions;
- (f) objective sharing of risks between the parties; and
- (g) financial sustainability and socioeconomic advantages of PPP projects.

These guidelines mirror the spirit of care the legislator wishes government entities to adopt when contracting PPPs, reminding them of certain principles and concepts already contemplated by the legislation applicable to contracting of works, services, and other items by government entities with companies of the private sector.

2.2 PPPs and concessions

PPPs and concessions - the so called "ordinary concessions", regulated by the Fed. Law 8,987, 1995 (the Brazilian General Law of Concessions) - may seem to be very similar. That is the reason why PPP Law expressly provides that PPP contracts must meet the general requirements of the Brazilian General Law of Concessions for contracts, such as:

- (a) tariff adjustment mechanisms;
- (b) methods and standards for service evaluation;
- (c) expansion and inspection; indemnity calculations;
- (d) users' rights and duties; and
- (e) periodical rendering of accounts by the private party to the public party.

Nevertheless, important distinctions should be made between concessions and PPPs. Concession contracts, as defined in the Brazilian General Law of Concessions, comprise all those in which government entities delegate the provision or performance of services (whether or not preceded by public works) to a private entity, which will perform the activities inherent to the services and

10^a Conferência Internacional da LARES - "PPP projects in Brazil: Opportunities and challenges for the construction and engineering industries" (Júlio César Bueno).

assume the business risk under the contractual conditions. In concessions, the compensation obtained by the concessionaire always originates from the service users only.

On the other hand, PPPs are slated for services and/or public works that do not generate sufficient compensation to the contractor (*e.g.* expansion and management of highways or railroads with few users) or that do not even involve payment of fees by their users (*e.g.* construction and management of penitentiaries or public hospitals). Therefore, in addition to dealing with cases requiring investments and/or specialization beyond the possibilities of the public entity, PPPs have another specific characteristic: the venture itself is unable to pay off.

Unlike ordinary concession contracts, PPP contracts are subject to more extensive and complex regulations. The methods of compensation and the guarantees tendered (guarantee fund, insurance, etc.) by the public entity to the contractor, the risk sharing between the parties, the possibility of transferring the special purpose company (a legal entity incorporated to enter into PPPs) to financiers in case of default, the definition of performance evaluation criteria in accordance with the contractual term, among others, will be a matter of concern of those involved in drafting and negotiating PPP contracts.

2.3 Types of PPPs

According to the PPP Law, PPPs are administrative concession contracts that can be of two different types:

- (a) sponsored concession - a concession contract for the provision of public services or public construction works (with subsequent provision of a public service), established by the Brazilian General Law of Concessions, under which the Public Administration provides a direct payment in addition to the tariff charged to and payable by the users; and
- (b) administrative concession - a contract under which the public service, that may involve carrying out public construction works or supplying and installing fixed assets, is provided directly or indirectly to the Public Administration which, in turn, provides all the compensation to the private partner for rendering such public service.

Under the the PPP Law, the following activities shall not be defined as PPPs:

- (a) contracts with value lower than R\$ 20,000,000.00 (twenty million reais);
- (b) contracts that its term for the provision of services is less than 5 years; and
- (c) contracts of which purpose is solely to supply labor, installation of equipment or the execution of public construction works, which will continue to be subject to the General Administrative Contracts Act.

2.4 Tendering process

The selection for the PPP contracts should be made through competitive public bids always under the pre-qualification system and preceded by a public audience. In choosing among bids

10^a Conferência Internacional da LARES - “PPP projects in Brazil: Opportunities and challenges for the construction and engineering industries” (Júlio César Bueno).

submitted, the decision will be based on the criteria of the lower tariff to be charged the enduser and the lower compensation to be paid by the Public Administration, as well as a combination of these criteria with technical expertise.

Moreover, the invitations to bid may provide for the possibility of reversal in the order of the phases related to selection and assessment and presentation of live bids to choose among selected written offers. The opening of the tendering process requires:

- (a) authorization by the public authority, based on a technical study that shall demonstrate the convenience and appropriateness of contracting model;
- (b) the expenses created or increased shall not affect the targets in terms of fiscal results, such that its financial effects, in subsequent periods, shall be compensated by a permanent increase in revenues or by a permanent reduction in expenditures; and the payment obligations undertaken by the Public Administration in partnership contracts;
- (c) estimate of budgetary and financial impact in the periods in which the public-private partnership contract shall be in effect;
- (d) statement by the party responsible for authorizing the expenditure that the obligations undertaken by the Public Administration in a partnership contract are in line with the Budget Guidelines Act and have been considered in the Annual Budget Act;
- (e) estimate of long-term flow of public funds, necessary for fulfilling, throughout the term of the contract and in each fiscal year, the financial obligations undertaken by the Public Administration;
- (f) the project is included in the Multi-Year Plan in effect;
- (g) submission of the draft invitation to tender and the draft contract to public consultation, which should be advertised in the official press, and
- (h) prior environmental license or release of guidelines for the environmental licensing of the project, as required by regulation.

The competitive tendering shall comply with the procedures set forth in the legislation that regulates tenders and administrative contracts and also the following the bid appraisal may be preceded by a qualifying stage of technical proposals, in which bidders that do not attain a minimum number of points are disqualified, not taking part in the subsequent stages and may adopt the following criteria:

- (a) lowest payment by the Public Administration; and
- (b) best proposal as the result of a combination of the criterion of both criteria.

The invitation to tender may allow a reverse tendering procedure, in which the bid appraisal stage precedes the qualifying stage. In this case:

- (a) after the bid appraisal, the envelope with the qualification documents from the bidder who made the best offer shall be opened, in order to verify compliance with the requirements established in the invitation to tender;

- (b) after compliance with the requirements of the invitation to tender has been attested, the bidder who made the best offer shall be declared winner;
- (c) if the bidder who made the best offer is not qualified, the qualification documents of the second best proposal shall be examined, and so forth, until a classified bidder complies with the requirements established in the invitation to tender; and
- (d) upon announcement of the final result of the tendering process, the contract shall be awarded to the winner, in accordance with the technical and economic conditions proposed.

2.5 Some mandatory clauses are required in PPP contracts

The clauses of PPP shall state the:

- (a) term of the contract, which shall be in line with the amortization of the investments to be made by the private partner, not shorter than 5, and not longer than 35 years, including possible extensions;
- (b) penalties applicable to the Public Administration and to the private partner in case of non-compliance with contractual obligations;
- (c) sharing of risks among the parties, including those that refer to acts of God, force majeure, acts of State and unforeseeable events;
- (d) forms of remuneration and adjustment of contractual values;
- (e) mechanisms to preserve the nature of the service provision;
- (f) facts that trigger public sector payment default, the means and terms for reestablishing the payment stream and, if applicable, the form by which guarantees are enforced;
- (g) objective criteria for evaluating the performance of the private partner;
- (h) provision by the private partner of performance guarantees compatible with the burdens and risks involved, subject to the limits established;
- (i) sharing with the Public Administration of the economic gains of the private partner resulting from the reduction of credit risk related to the funding contracted by the private partner;
- (j) inspection and due diligence of the assets to be transferred to the public sector, which shall enable the public authority to withhold payments to the private partner, in the amount necessary to repair any irregularities that may be detected;
- (k) the requirements and conditions under which the public sector can authorize step-in-rights in favor of the financial institutions that funded the SPC, with the objective of promoting its financial restructuring and ensuring the continuity of service provision;
- (l) the possibility that public sector payment can be made directly to project funders; and

10^a Conferência Internacional da LARES - “PPP projects in Brazil: Opportunities and challenges for the construction and engineering industries” (Júlio César Bueno).

(m)the legitimacy of project funders to receive compensation for early termination of the contract, as well as payments made by funds and state-owned enterprises acting as guarantors of PPP.

The payments from the Public Administration to the private partner shall obligatorily be preceded by service delivery and may take the form of: bank draft, assignment of non-tax credits, granting of rights against the Public Administration, granting of rights over real estate owned by the government or other means permitted by law. The contract may stipulate a variable payment to the private partner linked to its performance, which shall be assessed against required quality and availability standards. Before contract award, bidders must set up a special purpose company (SPC), which shall be responsible for implementing and managing the project. This may be a publicly traded corporation and shall comply with corporate governance standards and adopt standardized accounting and financial statements.

The use of private mechanisms for dispute resolution, including arbitration, to be conducted in Brazil and in the Portuguese language, in order to resolve conflicts that may arise in relation to the contract.

2.6 The role of guarantees in PPPs

From the time the Executive Branch proposed Bill 2,546, 2003 - which was later passed as the PPP Law -, the efficacy of the guarantees to be tendered by the Federal Government for Project Finance purposes has been extensively debated. After all, the success of PPPs - in Brazil or elsewhere - basically hinges on the capacity to convince private partners and sponsors that the Government will honour its long-term contractual obligations and that, in case of government default for any reason, these partners and sponsors will be able to rapidly and efficiently foreclose on such guarantees seeking redress of any losses caused by said default.

In general terms, the difference between a PPP and a public utility concession (or authorization or license) is that, in the PPP mode, private enterprise builds the necessary infrastructure work and subsequently, under a contract and in return for a compensation payable by the public partner, such work is placed at the disposal of the Government which then directly provides the respective utility service. In a concession, however, private enterprise directly provides the public service in lieu of the Government, which in turn grants such private entity the right to do so.

For example, a private partner under a PPP arrangement builds a hospital according to the government specifications and then “leases” a specific number of hospital beds to be used by the Government in public health services under a long-term contract. The income earned from a project built by the private partner - and, therefore, the financial results that will serve to repay the respective project finance transaction - comes from government payments during a preset contractual period in consideration for the infrastructure work made available to it. In a concession, the Government gives a private party the right, for example, to provide telephony services to the public at large, according to pre-established rules and standards. The service is directly rendered by the private enterprise, and its income derives from the tariffs payable by users for such service.

PPP Law created two separate categories, namely a sponsored concession, a mere combination of the ordinary concession mechanism governed by the Brazilian General Law of Concessions,

together with a compensation paid by the public partner; and an administrative concession, which is the very essence of PPP as described above. In either situation, the difference between PPPs and ordinary concessions lies in the origin of the private enterprise's income, which in the first case comprises payments made by the Government (or a combination of payments made by the Government and the tariffs charged to service users, in the case of a sponsored concession), while in the second case such income is exclusively made up of the tariffs charged to service users.

In England, the fact that the Government contractually undertakes to make payment under a PPP project is, in itself, an excellent assurance of firm and lasting income, given that the British Government has always been a good payer. This system represents a lower risk that is easier to be assessed (and, as such, makes funding easier, at more attractive rates) than a system involving income from services provided to the public at large, which may vary according to the whims of the market.

Brazil, however, represents a completely different reality. As Administrations change, the incumbent administration sometimes seeks ways to avoid honouring the obligations assumed by its predecessor that could hurt the government budget in light of its own priorities. Within this scenario, the guarantees tendered to secure all contractual obligations regardless of the incumbent Administration - or, in case of default, to ensure investors ways to secure the contracted income - become fundamental for implementation of PPPs in Brazil. In this area, various innovations brought by PPP Law are notable.

PPPs projects must be implemented and managed by a Special Purpose Entity, whose majority voting capital cannot be held by public administration entities. Although the transfer of SPE control hinges on express authorization of the competent authorities, the requirements and conditions for such authorization given to the project sponsors with a view to promoting financial reorganization and non-interruption of the services can be stipulated in the PPP contract.¹ Therefore, it is fundamental for the security of said financing institutions that these requirements and conditions ensuring authorization for transfer be stipulated thoroughly and in detail so that this authorization cannot be unreasonably withheld.

In this case, the project sponsors will not have to fulfil the requirements of technical capacity, financial condition, legal and tax standing to assume this service. Likewise, the PPP contract may lawfully stipulate:

- (a) the possibility of issuing a government budget allocation note in the name of the project sponsors to secure the pecuniary obligations of the government partner; and
- (b) the financial sponsors' entitlement to indemnification in case of early termination of the contract as well as to payments made by the funds and government-owned companies acting as PPP guarantors.²

The guarantees established to secure pecuniary obligations of the public partner in PPP contracts are listed in Article 8 of PPP Law, namely:

¹ Article 5, paragraph 2, I, and Article 9 of the PPP Law.

² Article 5, paragraph 2, II and III of the PPP Law.

- (a) escrow of revenues;
- (b) formation or use of special guarantee funds set out in law;
- (c) performance bond;
- (d) guarantees tendered by international organisms or financial institutions;
- (e) guarantees offered by a guarantee fund or government-owned company organized for this purpose; and
- (f) other mechanisms prescribed by law.

Therefore, the aforementioned guarantees can be tendered on a cumulative, non-exclusive basis. Escrow of revenues must observe constitutional restrictions against the escrow of tax revenues.³ However, revenues from other sources can be kept in escrow to secure the public partner's obligations. The special funds set out in law, or the funds organized under legislative authorization, can also secure the obligations undertaken by the public partner, and escrow funds may be used for achievement of this purpose.

Performance bonds must be taken out with insurance companies that are not controlled by the public partner; however costly, this mechanism represents an interesting guarantee in terms of liquidity and insurable risks. In general terms, a performance bond covers the risks underlying the fulfilment of obligations undertaken by the insured (in this case, the public partner). If an insurable event materializes, the insurance company will honour a claim tantamount to the unfulfilled obligation.

Another advantageous aspect of insurance is the possibility of directly designating the financial sponsors as the beneficiaries in the policies, instead of the private partners themselves. The public partner in favour of its private partners or sponsors may now offer this type of insurance, required by the government authorities in bidding procedures. Of course, the higher the risk of contractual default on the part of the public partner, the higher the cost involved in obtaining this performance bond.

If the public partner obtains guarantees from international financing institutions (such as the Interamerican Development Bank (IDB), the Organization for Economic Cooperation and Development (OECD), the International Finance Corporation (IFC), the Japanese Bank for International Cooperation (JBIC), or the Multilateral Investment Guarantee Agency (MIGA), or from private banks not controlled by the government authorities, these guarantees may also be extended to PPP financial sponsors, provided that the National Monetary Council and Central Bank rules on credit allocation to the public sector are observed.

Guarantees for PPP projects tendered through a guarantee fund organized for this purpose are specifically provided for in PPP Law, which lays down the rules applicable to the Public-Private Partnership Guarantee Fund (*Fundo Garantidor de Parcerias Público-Privadas*).

The Federal Government, its independent agencies and public foundations were expressly authorized to hold FGP shares up to the aggregate limit of R\$ 6 billion, paying up their

³ Article 167, VI, of the Brazilian Federal Constitution.

respective shares by way of contribution of cash, government bonds, government-owned real properties, moveable assets (including shares of federal mixed-capital companies in excess of what is required for federal government control), or other rights with property value.

The sole purpose of the Public-Private Partnership Guarantee Fund is to secure the pecuniary obligations of the federal government entities under PPP contracts. One of the following types of guarantees may be tendered as approved at a shareholders meeting:

- (a) surety (*fiança*), without the privilege of order for the guarantor;
- (b) pledge of movable properties or rights that make up the FGP equity, without transferring possession of the pledged asset until enforcement of the guarantee;
- (c) mortgage of real properties;
- (d) conditional sale in which the Public-Private Partnership Guarantee Fund or the trustee it appoints will continue in possession of the assets;
- (e) other collateral contracts; or
- (f) a collateral or personal guarantee covered by separate assets and rights of the Public-Private Partnership Guarantee Fund.

As an incentive for government entities to hold Public-Private Partnership Guarantee Fund shares, PPP Law established that its guarantees would be tendered rateably to the respective number of shares held. By establishing that other legally permitted mechanisms can be offered as a guarantee for obligations of the federal partner, the lawmakers have wisely left a precious “legal window” open in PPP Law. This is because the possibility of adopting any legally acceptable guarantee mechanisms lends sufficient flexibility to meet the specific demands of each case. Due to its features and flexibility, the Public-Private Partnership Guarantee Fund mechanism will certainly be the most commonly used for giving guarantees and back bonds in PPP projects within the realm of the federal government entities.

The Public-Private Partnership Guarantee Fund may offer back bonds to insurance companies, financial institutions and international entities securing the PPP projects of the Public-Private Partnership Guarantee Fund shareholders:

- (a) in case of liquidated credits originating from a debt instrument accepted but unpaid by the public partner, the Public-Private Partnership Guarantee Fund guarantee may be enforced as from the 45th day of default;
- (b) the private creditor may enforce the Public-Private Partnership Guarantee Fund guarantee for debts stated on invoices that have been issued but not accepted by the government entities, unless such invoices were expressly and reasonably denied within 90 days from the due date; and
- (c) in the event of default, the Public-Private Partnership Guarantee Fund assets and rights may be subject to a judicial lien and further sale to satisfy the secured obligations.

2.7 The division of extraordinary risks in PPPs

The attainment of efficiency depends on the presence of specific supply and demand conditions. When a private operator bids for a project, it is on the basis of expected (future) conditions. The

10^a Conferência Internacional da LARES - “PPP projects in Brazil: Opportunities and challenges for the construction and engineering industries” (Júlio César Bueno).

definition of risk differs depending on the amount of information about the future available. The classes of risk are:

- (a) certainty - A case of full information on the future, so that an entrepreneurial decision would not be subject to any risk. However, full information is a limiting case which does not appear in reality.
- (b) risk proper – A case where the range of possible outcomes and their objective (*i.e.* statistically determined) probabilities are known. This means that the future is, to a degree, susceptible to statistical measurement in terms of probabilities. If a statistical or probability distribution can be determined in practice, it could form the basis for entrepreneurial decisions with a ‘statistically justified’ degree of confidence (albeit still with risk).

Risk sharing between the government and the concessionaire has been always a concern among practitioners and policy makers. The standard prescription is that each risk should be allocated to the party best able to manage it. Others say that each risk should be allocated to maximize project value, taking account of moral hazard, adverse selection and risk-bearing preferences.

In relation to sharing of extraordinary risks, recent PPP project contracts entered into in France contain a clause that was included to protect the original economic conditions, compelling the parties to renegotiate the terms of the contract in order to re-establish the original financial conditions before any action unilaterally taken by either party caused a strong impact on the economic condition of the contract. In the event such balance has been breached by any change in economic, financial, legal, tax or social conditions, the parties should agree under the contract that they would put forth all efforts to restore its original status. In both cases, the parties agree that the PPP contact cannot be structurally imbalanced.

Actually, clauses providing for the sharing of risks between the private and public sectors in cases of force majeure or changes in local laws are part of standard contracts in effect in the United Kingdom, including provisions for any contractual extensions, tariff adjustments or additional grants, and to a large extent they were adopted by the other European countries when preparing the documents for PPP projects.

One of the innovations brought by PPP Law was the allocation of risks between public and private partners. Therefore, certain special precautions should be taken by private companies willing to enter into partnerships with the Public Authorities, since non usual risk allocation may eventually render the project unfeasible. It is important to identify these risks and determine how such allocation will be accomplished. This concern is reflected in Guide for Successful Public Private Partnerships, published by the European Commission in March 2003.⁴ The same concern should apply to the Brazilian PPP framework.

⁴ In such work, the European Commission concluded that: “There is some debate as to how much risk should be transferred from the public to the private sector. Generally, the more risk transferred to the private sector partner, the more financial reward the private partner will demand. Risks should be allocated to the party who can best assume it in the most cost effective manner.”

Article 4, VI and Article 5, III, of the PPP Law deal with risk allocation.⁵ Article 5, III, stipulates that PPP agreements must include provisions establishing the allocation of risks between the parties, including risks relating to acts of God, force majeure, acts of state and extraordinary unforeseen economic events.

To properly understand and interpret such Article, it is first necessary to analyze the risks involved in a PPP. In this Article, these risks have been divided into operating risks and extraordinary risks. Operating risks are defined as all those inherent to the project to be executed. These risks involve implementation of the basic design, delivery of the work, payment method, default by users, and so on.⁶ Extraordinary risks, in turn, are those whose effects and consequences are difficult to foresee, and when they occur may represent a burden of such magnitude for the work or operation that may render it economically unfeasible. These risks derive from several situations, such as acts of nature or drastic economic changes such as massive currency devaluation or the imposition of customs barriers on the importation of inputs. Law usually defines such events as acts of God, force majeure, and acts of state and extraordinary unforeseen economic events.

In ordinary concessions, governed by the Brazilian General Law of Concessions, operating risks fall on the private concessionaire, since it is charged with managing the project. Extraordinary risks, in turn, are managed by the Public Authorities by maintaining the original economic and financial spirit of public contracts. This mechanism ensures that the economic and financial conditions relied on by the parties when entering into the contract is maintained until its expiration.

Maintenance of this original spirit is not only a guarantee for the private contractor but also a manner of ensuring that the public interest is served. If the private partner had to bear the burden of unforeseen events or unilateral contractual changes made by the Administration, it could be forced to interrupt the services or public works due to lack of financial and economic conditions. Another alternative would be to take out insurance to cover unforeseen events. This, however, would increase costs enormously. It is evident that interruption of a work or the increase in its cost jeopardizes both the public interest and the public coffers.

PPP Law, however, does not clearly define the mechanism by which the original economic and financial spirit of the contract would be maintained. As Article 5, III, stipulates that both extraordinary and operating risks should be shared, in theory the private partner, when joining a PPP, will be unable to fully assess the contingencies involved should it be required to share extraordinary risks.

Therefore, unless a regulatory or contractual mechanism allows the parties to predict and possibly limit extraordinary risks, the private partner may be forced to include in its proposal the high costs to be incurred with insurance and guarantees, which would substantially increase the project costs. Not doing so would probably lead to interruption of the project due to lack of financial and economic capability of the private partner.

⁵ Article 4, VI, of the PPP Law: “Contracting of public private partnerships shall observe the following guidelines: ... VI - objective risk allocation between the parties.”

⁶ For instance, in a toll road concession the mere decrease in the flow of cars that use the road, in principle, is an operating risk inherent to the business.

Consequently, when negotiating PPP contracts, the Public Authorities, by means of regulations, or the partners themselves should clearly define, in a manner commensurate with their respective capabilities, both the operating and extraordinary risks they intend to assume. It is advisable that the extraordinary risks borne by the private company be limited so as to avoid an excessive burden, which would force it to suspend its activities and ultimately threaten the public interest itself.

2.8 The legal limitation and the consideration of the public administration

The means for payment of private partners, as listed in the PPP Law, are:

- (a) banker's order;
- (b) assignment of non-tax receivables; and
- (c) granting of rights before the Public Administration and over public domain assets.

These are not the only means of payment, since current Brazilian legislation contemplates other forms of compensation. Bearing this in mind, it is important to examine the stand adopted by the Public Administration *vis-à-vis* private partners.

The PPP Law stipulates that the compensation paid by the Public Administration may be linked to the private entity's performance, in accordance with the quality and availability goals and standards set out in the contract executed with the Public Administration.

Even though PPP contracts may link compensation to the private entity's performance, the PPP Law already stipulates that any compensation paid by the Public Administration must be mandatorily preceded by total or partial availability of the service to be provided under the partnership contract.

Therefore, irrespective of the form of compensation adopted by the Public Administration, private entities must fully or partially perform the contracts executed with the public partner before receiving due compensation.

These provisions reflect the State's interest in ensuring proper performance of PPP contracts by private partners. The PPP Law caps the amount the Federal Government may spend in PPPs at 1% of its net revenues. In other words, the Public Administration may only contract PPPs when:

- (a) the sum of recurring expenses incurred with PPP contracts already signed has not exceeded, in the previous year, 1% of the net current revenues for that fiscal year; and
- (b) the annual expenses incurred with the existing contracts, in the 10 subsequent years, do not exceed 1% of the net current revenues projected for the respective fiscal years.

The abovementioned caps will also apply for tendering of guarantees and grants allocated by the Federal Government to the States, the Federal District and the Municipalities. In such events, when applying the 1% *cap*, the expenses arising from PPP contracts entered into by the direct Public Administration, independent agencies, public foundations, government-owned companies, mixed-capital companies and other entities directly or indirectly controlled by the public partner, will be taken into account.

10^a Conferência Internacional da LARES - "PPP projects in Brazil: Opportunities and challenges for the construction and engineering industries" (Júlio César Bueno).

The limits imposed by the PPP Law set out an objective criterion for monitoring public debts, thus avoiding excessive indebtedness. The PPP Law subjects the Public Administration to Fiscal Responsibility Law, provides guidelines for the State's actions, and stipulates penalties for noncompliance with such limits.

The lawmaker's intention of providing integrity and transparency to PPPs, thus attracting the investors (private partners) necessary to make a success of this Federal Government project, is reflected in the mechanisms provided in the law to put a cap on Public Administration indebtedness and to limit the requirements imposed for payment of compensation to the private entities.

2.9 Financing limitation and the resources from the public sector

A great deal has been said about the PPPs formed by the government and the private sector through Special Purpose Entities, particularly with regard to allocation of risks, rights and duties between the public and private sectors. Special rules, imposing limits on funding to Special Purpose Entities by the public sector, have been devised to implement such projects without unduly burdening the public coffers. Such rules are set out in the PPP Law, which regulates PPPs, and seek to avoid that all credit risks arising from PPP operations fall exclusively on the public sector.

One of the essential features of PPPs is the sharing of profits and losses from each project. As a result, it is only logical that such sharing also applies to credit risk, since Special Purpose Entities will have to obtain at least part of their operating funds from the private sector. Article 27 of the recently enacted PPP Law has addressed this issue by capping the credit extended by government-owned companies or mixed-capital companies controlled by the Federal Government to Special Purpose Entities at 70% of the total funding sources of the Special Purpose Entities. This limit is increased another 10% for PPP projects carried out in the North, Northeast and Midwest of Brazil, provided that the Human Development Index in the region is lower than the average Brazilian index. This flexibility reflects the lawmaker's intention of fostering PPP projects in Brazil's poorer areas.

The PPP Law also imposes limits on the Special Purpose Entities funding sources (whether through credit or capital contribution). Thus, the equity interest held by closed-end private pension entities and government-owned companies or mixed-capital companies controlled by the Federal Government in Special Purpose Entities is capped at 80%. Like the previous rule, this limit may be increased a further 10% when the PPP project is to be developed in the North, Northeast and Midwest regions, provided their HDI is lower than the national average. It is therefore imperative that part of the Special Purpose Entities operating funds comes from the private sector. Private financial institutions will soon get involved in PPP projects, thus creating a new market niche for this sector.

Within this context, it is worth looking into the rules limiting credit to government entities, more specifically those set out in Brazilian Monetary Council Resolution No. 2,827, 2001 (Resolution 2,827), as amended and regulated. Such resolution imposes restrictions on the credit offered by financial institutions to companies belonging to the public sector, setting criteria for such limitations on the basis of the total capital (*patrimônio de referência*) of each institution, as well as the aggregate value of such transactions, in compliance with applicable regulations.

10^a Conferência Internacional da LARES - “PPP projects in Brazil: Opportunities and challenges for the construction and engineering industries” (Júlio César Bueno).

For the purposes of Resolution 2,827, “public sector bodies and entities” is understood to be, among others, “non-financial mixed-capital companies and government companies, their subsidiaries and other companies directly or indirectly controlled by the Public Administration, including special purpose companies.” If it is determined that Special Purpose Entities fall within the above definition, the restriction set out in Resolution 2,827 regarding credit offered by private financial institutions would apply to Special Purpose Entities. It is worth noting that the PPP Law stipulates a minimum of 20% - or 10%, depending on the case - of private funds for Special Purpose Entities.

One may perfectly sustain, however, that Special Purpose Entities are not public sector entities, since the PPP Law it sets out that the Public Administration cannot own a majority of the voting stock in Special Purpose Entities. Therefore, there being no control by the Public Administration, Special Purpose Entities would not be subject, in principle, to the limitations imposed by Resolution 2,827 and, consequently, the treatment given by financial institutions to Special Purpose Entities would be identical to that afforded to private entities in other credit transactions.

In line with the essential nature of PPPs, *i.e.*, the sharing of risks, rights and obligations between the public and the private sectors, the PPP Law sought to avoid that the funds channelled to PPP operations originate entirely from public entities. This will open a window of opportunity for the private sector in the financing of PPPs projects.

3 CONCLUSION

3.1 A pragmatic approach is needed

By definition a PPP is a pragmatic approach. The evaluation of PPPs will have to deal with the full economic complexity of the issue, liberated from ideological shackles, also including institutional and practical considerations. Part of the complexity of PPPs derives from the fact that these institutional arrangements blur the distinction (or border) between government and private sector. Standard concepts and measures of, for example, the public sector and government budget deficits are obscured, requiring rather clear-headed analysis. A spectrum of complex, composite relationships have to be considered and implemented to be successful.

A multitude of economic and social objectives tend to be mentioned when people discuss the benefits of PPPs, the most important of which is improved efficiency and effectiveness. The validity of arguments may be conditional upon circumstances, *i.e.* the probability of the success of a PPP may depend on the particular case and circumstances. As the economics of PPPs is still imperfectly understood, practice has run ahead of theory. Some practitioners and governments claim that PPPs relieve strained budgets and release public funds while others suggest that PPPs are appealing because finance, investment and management is delegated to private firms, which are more efficient.

In general it is important to develop a set of conditions, guidelines and criteria for the economic rationale for PPPs to be valid, and for a potential PPP to be successful and sustainable. This is likely to depend on the kind of product or service, amongst other things. Truth is that the debate on PPPs is inescapably linked to the broader debate on the role of government in the economy

10^a Conferência Internacional da LARES - “PPP projects in Brazil: Opportunities and challenges for the construction and engineering industries” (Júlio César Bueno).

and in society. Therefore, it is likely to be influenced (or dominated) by prior ideological positions favouring a larger or a smaller role for the public sector.

Effectiveness of service delivery is essential and efficiency of delivery highly desirable. For some services neither government alone nor the private sector alone can deliver services effectively or efficiently. This is due to, *inter alia*, the “public” nature of the product, the bureaucratic nature of government, and the profit-orientated nature of the private sector. Therefore, one must consider a partnership model (*i.e.* a PPP). However, benefits will only be realised if two key ingredients of a PPP are present. These are a true partnership and sufficient risk transfer. To get these ingredients active, it requires both commonality of purpose and an effective incentive, reward and competitive discipline framework (actual or simulated). The latter, which is essential, requires a carefully designed contractual and regulatory framework which can overcome many of the inherent problems of such a situation.

PPPs require an efficient regulatory and managerial framework to simulate competitive pressures and ensure correct incentives. Unfortunately a lack of sufficient management capacity in government is the main reason for considering PPPs in the first place. PPPs attempt to circumvent inefficiency due to per-verse bureaucratic behaviour and incentives. However, the regulatory and managerial framework that they require can easily suffer from the same incentive and inefficiency problems. The regulatory framework required by a PPP is vulnerable to serious principal-agent problems and regulatory “capture”, especially in the long run. In short, PPPs do not constitute a magical panacea for social service delivery in times of budgetary constraints.

3.2 International trends and lessons learned

International experience has shown that some factors may be viewed as essential for success of the PPPs - starting with a stable legal system that is organized and favourable to the creation and development of PPPs. Although there are certain features in common between PPPs and concessions, there are numerous conflicts that do not allow using legislation drafted to govern concessions without first creating a legal environment specifically geared to PPPs. Because the United Kingdom was a pioneer in PPPs, its legal structure has been an inspiration for various other countries, which decided to first conform their legislation to provide the necessary support for PPPs.

Such adjustments have provided the public authorities with the ability to fulfil their obligations *ultra vires* while giving the private sector sufficient commercial security to develop projects, since the public sector will not be allowed to terminate business transactions without due compensation to the private sector. It should be noted that the laws and rules differ for each sector, as international experience has increasingly acknowledged the fundamental difference between various sectors of the economy, which rules out the possibility of a single law governing the matter.

Besides the special importance ascribed to the legal environment of PPPs, it is essential to verify the criterion for determining public projects that should qualify for the benefits of PPPs. Considering that the fundamental objective is to obtain efficiency and related gains by allocating project risks to the party that has the best conditions to administer them, a series of directives were devised in the United Kingdom to guide the development of an assessment indicator for the public sector. This index is based on the present value of the project; on the efficiency of the

10^a Conferência Internacional da LARES - “PPP projects in Brazil: Opportunities and challenges for the construction and engineering industries” (Júlio César Bueno).

current method used by the public sector in developing the project; and on the risks that must be faced by the public authorities in implementing the project.

Creation of this index, to the extent possible, aims to standardize evaluation of each project even without establishing preset rules for a final decision, and to permit a certain degree of flexibility when examining each project, which evidences a strong international trend to standardize the documents involved in PPPs.

France, Spain and Portugal have drawn on the United Kingdom experience in an effort to centralize directives for preparation of documents and, in certain cases, to draft standardized contracts that will simplify negotiation of the terms and conditions for the relationship to be maintained with the private partner under a certain PPP project. Although the first directives were issued in the United Kingdom in July 1999, the Office of Government Commerce (UK-OGC) only recently reviewed and compiled all the previous work carried out in this sense, resulting in the UK-OCG Directives. The basic objectives of these rules are:

- (a) to promote a common understanding regarding the risks normally faced in a typical PPP project;
- (b) to be consistent in relation to conducting negotiations and to establishing prices in similar projects; and
- (c) to reduce the time and costs of negotiation in matters that can be more easily agreed on with a standard contract.

UK-OGC Directives are general rules, since - although experience has shown that it is possible to standardize contracts in similar PPP projects - the gap between projects to be developed in different areas is well known. As a consequence, several other compiled guidelines have emerged, specifically related to the education, transportation and hospital areas, depending on the experience of each country. The needs and experiences in PPPs projects vary among the different countries. The United Kingdom has focused on PPPs in the education, health and construction sectors. Italy and Portugal initially focused on the health sector; the Netherlands in infrastructure; Norway and Ireland in the transport area; and Canada has already submitted a project using PPPs to modernize and expand the courts and other judiciary bodies.

The evolution of PPPs worldwide has involved adapting the legal systems in countries that elected to adopt partnerships. Besides, there is a strong inclination for standardization of documents involving PPP projects. The experience assimilated by the European forerunners of PPP projects has been shared by other public authorities, which, however, will have to evaluate their own needs, seeking projects that will best benefit the local public while providing a strong incentive for the private sector to participate in country's development.

3.3 A view on the future

A PPP is a contractual agreement between a public agency (federal, state or local) and a private sector entity. Through this agreement, the skills and assets of each sector (public and private) are shared in delivering a service or facility for the use of the general public. In addition to the sharing of resources, each party shares in the risks and rewards potential in the delivery of the service and/or facility. Different types PPPs have been practiced in worldwide infrastructure

10^a Conferência Internacional da LARES - “PPP projects in Brazil: Opportunities and challenges for the construction and engineering industries” (Júlio César Bueno).

development with diverse results and a variety of problems have been encountered. A number of factors combine to determine the success or failure of an infrastructure project in terms of its objectives.

In Brazil, the PPP Law merits praise for addressing the serious existing deficits in Brazilian infrastructure. The initial phase of the PPP programme mainly focuses on the transport sector, comprising modernisation of highways, ports and the construction of railways. As a parallel interest, it also deals with projects for the irrigation of agriculture in the semi-arid Northeast region. It is expected that the programme will comprise other areas of infrastructure such as energy and communications at a later stage.

The Brazilian Federal Union has so far proposed a charter of 23 projects with an estimated value of R\$13 billion for this initial phase of the programme which comprise:

- (a) 9 railway projects in all regions of Brazil (with the exception of the Northern region);
- (b) 7 highway projects involving construction or improvements of existing highways in the Northern, North-eastern and South-eastern regions;
- (c) 3 port projects regarding improvements to the Port of Itaqui (State of Maranhão), the Port of Sagatiba (State of Rio de Janeiro) and the Port of Santos (State of São Paulo);
- (d) irrigation projects in the Northeast (States of Bahia and Pernambuco) and in the area of Jaíba (State of Minas Gerais).

In parallel to the Federal Union Programme, Brazilian States are running their own PPP Programmes. Since the year 2003, the State of Minas Gerais approved its regulations on PPPs. Following Minas, the States of Santa Catarina, São Paulo, Goiás, Bahia, Ceará and Rio Grande do Sul have already passed their State PPP regulations. Some States are proposing their first charter of projects. These include, for instance:

- (a) State of Santa Catarina: 6 projects (on highways and ports);
- (b) State of São Paulo: 9 projects (on railways, highways, ports and urban trains);
- (c) State of Minas Gerais: 5 projects (urban water drainage, highways and civil construction).

The Federal Government has released information about the criteria used in the selection of PPP projects, both for the 23 projects mentioned above and for the future. The main criteria (in order of priority) are:

- (a) to be in accordance with the strategies of development of the Federal Government; 2) the project's capability to generate funds;
- (b) the extent of interest demonstrated by the private sector in the execution and financing of the project; and
- (c) the stage of development of the project.

On the other hand, it is clear that the Brazilian States will focus on their regional needs and propose their projects accordingly. It seems that this double PPP system, whereby both the

10^a Conferência Internacional da LARES - “PPP projects in Brazil: Opportunities and challenges for the construction and engineering industries” (Júlio César Bueno).

Federal Union and the individual States can develop their PPP projects, may assist in covering a wider spectrum and thus benefit a country of continental dimensions like Brazil. And it is clear that the PPP projects are welcomed by the Brazilian private sector and by the population in general, given the immense need for the modernisation of infrastructure in the country and the necessity of providing rapid and efficient answers to these needs. This initial phase, focusing on the renovation of the Brazilian transport system, is likely to have a positive impact on the Brazilian economy, by promoting the efficient transport of goods both inside Brazil and abroad.

3.4 Final remarks

The adoption of PPP contracts should be determined case by case. Both private and public partners will have to know that, by means of partnership contract, the government does not acquire direct service provision means but the very services and its performance, which will imply changes in procedures and in the managerial culture of the public services agents. Equally, responsibilities of contracted parties and their rights are empowered. On the other hand, the traditional double nature of concession as an authority act and contractual relationship, which is a core notion in the administrative contracts in the Civil Law system, is under test.

PPP projects are especially exposed to political risks. Therefore, it is necessary to assure proper participation by diverse sectors already in the design phase but also in the subsequent steps so that the benefits may affect broad groups of society and the cost be minimized and equitably distributed.

Finally, public sector activity should be exerted in a new way. This would stimulate innovative solution for problems in the relationship between contracted parts and these and customers, promoting a climate of mutual relations, which guarantees the bloom of partnership in spite of the most diverse difficulties.

4 REFERENCE

BENNETT R.J. AND KREBS G. *Local Economic Development: Public-Private Partnership Initiation in Britain and Germany*. London, United Kingdom: Belhaven Press, 1991.

Brandão, Luiz E. T. and Saraiva, Eduardo C. G. *Risco privado em infra-estrutura pública: uma análise quantitativa de risco como ferramenta de modelagem de contratos*. Rev. Adm. Pública, Dez 2007, vol.41, no.6, p.1035-1067. ISSN 0034-7612

BROWN C.V. AND JACKSON P.M. *Public Sector Economics*. Oxford, United Kingdom: Blackwell, 1990.

CAMPOS DE SOUZA, Mariana (coord). *Parceria Público Privada – Aspectos Jurídicos Relevantes*. São Paulo: Quartier Latin, 2008. 7. Parcerias Público-Privadas (PPP) no Estado de Minas Gerais - Novas modalidades para o Governo do Estado, juntamente com o setor privado, beneficiar milhões de mineiros. Disponível no site da Unidade de PPP de Minas Geais. Belo Horizonte: 2005.

CORRY, D. *Public Expenditure: Effective Management and Control*. London, United Kingdom: The Dryden Press, 1997.

GRILLO, Leonardo Melhorato. Melhado, Sílvio Burrattino (orient). *Modelo de análise da qualidade do investimento em projetos de parceria público-privada (PPP)*. São Paulo, 2008. 481 p.

_____ e MELHADO, Sílvio Burrattino. *Modelo de análise da qualidade do investimento em projetos de parceria público-privada(PPP)*. São Paulo, EPUSP, 2008. 26 p. Boletim Técnico da Escola Politécnica da USP, Departamento de Engenharia de Construção Civil, BT/PCC/520. (01039830).

HARDING R.W. *Private Prisons and Public Accountability*. Buckingham, United Kingdom: Open University Press, 1997.

LOPES ENEI, José Virgílio. *Project Finance: Financiamento com Foco em Empreendimentos (parcerias público-privadas, leveraged buy-outs e outras figuras afins)*. São Paulo: Saraiva, 2007.

CRETELLA, José. *Comentários à Lei das Parcerias Público- Privadas*. São Paulo: Forense, 2005.

MEDEIROS, Edmundo Emerson de. Bercovici, Gilberto (orient). *Infra-estrutura energética e desenvolvimento Estado, planejamento e regulação do setor elétrico brasileiro*. São Paulo, 2008. 157 p.

Mesquita, Arlan Mendes and Martins, Ricardo S. Desafios logísticos às redes de negócios no Brasil: o que podem as parcerias público-privadas (PPPs)? *Rev. Adm. Pública*, Ago 2008, vol.42, no.4, p.735-763. ISSN 0034-7612

MONTEIRO, Vera Cristina Caspari. Almeida, Fernando Dias Menezes de (orient). *A caracterização do contrato de concessão após a edição da lei 11.079/2004*. São Paulo, 2009. 226 p.

PORRUGAL RIBEIRO, Mauricio. Prado, Lucas Navarro. *Comentários à lei de PPP-parceria público-privada fundamentos econômico-jurídicos*. São Paulo: Malheiros, 2007.

PORRUGAL, Mauricio e NAVARRO, Lucas. *Comentários à Lei de PPPs*. São Paulo: Malheiros, 2007.

SCRIPTORE, Juliana Souza. Toneto Junior, Rudinei (orient). *A parceria público-privada no saneamento básico brasileiro uma proposta para o desenvolvimento do setor*. Ribeirão Preto, 2010. 139 p.

SUNDFELD, Carlos Ari (coord.). *Parcerias Público-Privadas*. São Paulo: Malheiros, 2005.

TALAMINI, Eduardo (coord.). *Parcerias Público-Provadas – Um Enfoque Multidisciplinar*. São Paulo: RT, 2005.

5 LEGISLATION - ENGLISH VERSION OF THE PPP LAW

FEDERATIVE REPUBLIC OF BRAZIL

ACT 11,079, ENACTED ON DECEMBER 30TH,
2004

Establishes general norms for public-private partnership tenders and contracts within the Public Administration

Chapter I PRELIMINARY PROVISIONS

Art. 1. This Act establishes general norms for public-private partnership tenders and contracts within the Federal Government, States, Federal District and Municipalities.

Sole paragraph. This Act shall apply to entities of the direct Public Administration, special funds, agencies, public foundations, state-owned enterprises, corporations with mixed public and private capital and other entities that are directly or indirectly controlled by the Federal Government, States, Federal District and Municipalities.

Art. 2. A public-private partnership is a concession contract, in the sponsored or administrative forms.

§ 1 A sponsored concession is a concession of public services or public works as established in Act 8987, dated February 13th, 1995, when it involves, in addition to user charges, a direct payment from the public sector to the private partner.

§ 2 An administrative concession is a contract for the direct or indirect provision of services to the Public Administration, even when it involves carrying out construction works or supplying and installing fixed assets.

§ 3 An ordinary concession, understood as the concession of public services or public works set forth in Act 8987, dated February 13th, 1995, shall not be considered a public-private partnership when no direct payment from the public sector to the private partner occurs.

§ 4 Public-private partnerships may not be contracted in cases where:

I - the contract value is less than R\$ 20,000,000.00 (twenty million reais);

II - the term for the provision of services is less than 5 (five) years; or

III - the sole scope of the contract is the supply of labor, the supply and installation of equipment or the execution of public works.

Art. 3. Administrative concessions shall be regulated by this Act and additionally by art. 21, 23, 25 and 27 to 39 of Act 8,987, dated February 13th, 1995, and art. 31 of Act 9,074, dated July 7th, 1995.

§ 1 Sponsored concessions shall be regulated by this Act, subject to the subsidiary application of the provisions of Act 8,987, dated February 13th, 1995 and its related acts.

§ 2 Ordinary concessions shall continue to be regulated by Act 8,987, dated February 13th, 1995 and by its related acts, not being subject to the provisions of this Act.

§ 3 Administrative contracts not characterized as ordinary, sponsored or administrative concessions shall continue to be regulated exclusively by Act 8,666, dated June 21st, 1993, and by its related acts.

Art. 4. The following guidelines shall be observed when contracting public-private partnerships:

I - efficiency in the fulfilment of the missions of the State and in the use of public resources;

II - respect for the interests and rights of service users and of private entities responsible for service provision;

III - non-delegation of regulatory and jurisdictional functions, as well as the exercise of enforcement powers and other State activities;

IV - fiscal responsibility when contracting and implementing partnerships;

V - transparency of procedures and decision-making;

VI - objective risk sharing among the parties;

VII - financial sustainability and socio-economic benefits of the partnership projects.

Chapter II PUBLIC-PRIVATE PARTNERSHIP CONTRACTS

Art. 5. The clauses of public-private partnership contracts shall be in accordance with the provisions of art. 23 of Act 8,987, dated February 13th, 1995, as applicable, and shall also state:

I - the term of the contract, which shall be in line with the amortization of the investments to be made by the private partner, not shorter than 5 (five), and

not longer than 35 (thirty-five) years, including possible extensions;

II - the penalties applicable to the Public Administration and to the private partner in case of non-compliance with contractual obligations, which shall always be determined proportionately to the magnitude of the offence committed and to the obligations assumed;

III - the sharing of risks among the parties, including those that refer to acts of God, force majeure, acts of State and unforeseeable events;

IV - the forms of remuneration and adjustment of contractual values;

V - the mechanisms to preserve the nature of the service provision;

VI - the facts that trigger public sector payment default, the means and terms for reestablishing the payment stream and, if applicable, the form by which guarantees are enforced;

VII - the objective criteria for evaluating the performance of the private partner;

VIII - the provision by the private partner of performance guarantees compatible with the burdens and risks involved, subject to the limits established in §§ 3 and 5 of art. 56 of Act 8666, dated June 21st, 1993, and, with regard to sponsored concessions, the provisions of item XV of art. 18 of Act 8987, dated February 13th, 1995;

IX - the sharing with the Public Administration of the economic gains of the private partner resulting from the reduction of credit risk related to the funding contracted by the private partner;

X - the inspection and due diligence of the assets to be transferred to the public sector, which shall enable the public authority to withhold payments to the private partner, in the amount necessary to repair any irregularities that may be detected.

§ 1 Clauses for automatic adjustment of contractual values based on indices and mathematical formulas, if any, shall be applied without need for express approval by the Public Administration, except when the latter publishes, in the official press, not later than 15 (fifteen) days after presentation of the invoice, reasons based on this Act or on the contract to reject the adjustment.

§ 2 In addition, the contracts may provide for:

I - the requirements and conditions under which the public sector can authorize step-in-rights in favour of the financial institutions that funded the special purpose company, with the objective of promoting its financial restructuring and ensuring the continuity of service provision, for which purpose item I of the sole paragraph of art. 27 of Act 8987, dated February 13th, 1995 shall not apply;

II - the possibility that public sector payment can be made directly to project funders;

III - the legitimacy of project funders to receive compensation for early termination of the contract, as well as payments made by funds and state-owned enterprises acting as guarantors of public-private partnerships.

Art. 6. The payments from the Public Administration to the private partner in public-private partnership contracts may take the form of:

I - bank draft;

II - assignment of non-tax credits;

III - granting of rights against the Public Administration;

IV - granting of rights over real estate owned by the government;

V - other means permitted by law.

Sole paragraph. The contract may stipulate a variable payment to the private partner linked to its performance, which shall be assessed against required quality and availability standards.

Art. 7. The payment provided by the Public Administration shall obligatorily be preceded by service delivery.

Sole paragraph. According to the terms of the contract, the Public Administration may pay the private sector partner for the portion of the service that is made available.

Chapter III GUARANTEES

Art. 8. The payment obligations undertaken by the Public Administration under a public-private partnership contract may be guaranteed by:

I - attachment of revenues, subject to the provisions of item IV of art. 167 of the Federal Constitution;

II - creation or use of special funds established in law;

III - obtaining surety bonds from insurance companies not controlled by the state;

IV - guarantees granted by international organizations or by financial institutions not controlled by the state;

V - guarantees provided by a guarantee fund or by a state-owned enterprise set up for this purpose;

VI - other mechanisms permitted by law.

Chapter IV SPECIAL PURPOSE COMPANY

Art. 9. Before contract award, bidders must set up a special purpose company, which shall be responsible for implementing and managing the project.

§ 1 Transfer of control over the special purpose company shall be conditioned to authorization by the Public Administration, as established in the invitation to tender and in the contract, subject to the provisions of the sole paragraph of art. 27 of Act 8,987, dated February 13th, 1995.

§ 2 The special purpose company may be a publicly traded corporation.

§ 3 The special purpose company shall comply with corporate governance standards and adopt standardized accounting and financial statements, as required by regulations.

§ 4 The Public Administration is forbidden from holding the majority of the voting capital of the special purpose company.

§ 5 The prohibition set forth in § 4 shall not apply to the possible acquisition of the majority of the voting capital of the special purpose company by a state-controlled financial institution, should the special purpose company default in its obligations under a loan agreement.

Chapter V TENDERING PROCESS

Art. 10. Public-private partnerships shall be procured by competitive tendering. The opening of the tendering process requires:

I - authorization by the public authority, based on a technical study that shall demonstrate:

a) the convenience and appropriateness of contracting a public-private partnership, by identifying the reasons that justify the choice of a partnership model;

b) that the expenses created or increased shall not affect the targets in terms of fiscal results provided for in the Annex referred to in § 1 of art. 4 of Complementary Act 101, dated May 4th, 2000, such that its financial effects, in subsequent periods, shall be compensated by a permanent increase in revenues or by a permanent reduction in expenditures; and

c) when applicable, in accordance with art. 25 of this Act, the compliance with the limits and conditions resulting from the application of art. 29, 30 and 32 of Complementary Act 101, dated May

4th, 2000, in relation to the payment obligations undertaken by the Public Administration in partnership contracts;

II - estimate of budgetary and financial impact in the periods in which the public-private partnership contract shall be in effect;

III - statement by the party responsible for authorizing the expenditure that the obligations undertaken by the Public Administration in a partnership contract are in line with the Budget Guidelines Act and have been considered in the Annual Budget Act;

IV - estimate of long-term flow of public funds, necessary for fulfilling, throughout the term of the contract and in each fiscal year, the financial obligations undertaken by the Public Administration;

V - the project is included in the Multi-Year Plan in effect;

VI - submission of the draft invitation to tender and the draft contract to public consultation, which should be advertised in the official press, in newspapers of general circulation and in electronic media, informing the arguments for contracting a partnership, the scope and term of contract, its estimated value, setting a minimum period of 30 (thirty) days for comments and suggestions, which shall end at least 7 (seven) days prior to the scheduled date for publishing the invitation to tender; and

VII - prior environmental license or release of guidelines for the environmental licensing of the project, as required by regulation.

§ 1 The evaluation of long-term public sector commitments, as stated in sub-items "b" and "c" of item I of the *caput* of this article, shall contain the assumptions and methodology used for calculation, subject to the general norms for public accounts, notwithstanding the examination of compatibility of the expenditures with the norms of the Multi-Year Plan and the Budgetary Guidelines Act.

§ 2 Whenever contract award occurs in a fiscal year other than the one in which the invitation to tender was published, the studies and evaluations referred to in items I to IV of the *caput* of this article must be updated.

§ 3 Sponsored partnerships in which more than 70% (seventy per cent) of the revenue of the private partner is to be paid by the Public Administration shall be subject to specific legislative authorization.

Art. 11. The invitation to tender shall contain a draft contract, shall expressly indicate the submission of the tendering procedures to the norms of this Act, observing, as applicable, §§ 3 and 4 of art. 15, art. 18, 19 and 21 of Act 8,987, dated February 13th, 1995, and may further provide for:

I - requirement of bid bond, subject to the limit established in item III of art. 31 of Act 8,666, dated June 21st, 1993;

II - (OVERRULED)

III - the use of private mechanisms for dispute resolution, including arbitration, to be

conducted in Brazil and in the Portuguese language, according to Act 9,307, dated September 23rd, 1996, in order to resolve conflicts that may arise in relation to the contract.

Sole paragraph. The invitation to tender shall specify, when applicable, the payment guarantees to be granted by the public sector to the private partner.

Art. 12. The competitive tendering for contracting public-private partnerships shall comply with the procedures set forth in the legislation that regulates tenders and administrative contracts and also the following:

I - the bid appraisal may be preceded by a qualifying stage of technical proposals, in which bidders that do not attain a minimum number of points are disqualified, not taking part in the subsequent stages;

II - the bid appraisal may adopt the following criteria, in addition to those provided for in items I and V of art. 15 of Act 8,987, dated February 13th, 1995:

a) lowest payment by the Public Administration;

b) best proposal as the result of a combination of the criterion of sub-item "a" with the best technical proposal, in accordance with the weights established in the invitation to tender;

III - the invitation to tender shall define the form for presenting the proposals, allowing the following formats:

a) written proposals in sealed envelopes; or

b) written proposals in sealed envelopes, followed by open outcry auction;

IV - the invitation to tender may allow bidders to amend proposals in order to rectify faults, insufficiencies or yet make corrections of a formal nature during the course of the proceedings, provided bidders are able to comply with the requirements within the time period established in the invitation to tender.

§ 1 In reference to sub-item "b" of item III of the *caput* of this article:

I - the bids in the open outcry auction shall always be submitted in the reverse order of classification of the written proposals and the invitation to tender shall not limit the number of bids;

II - the invitation to tender may restrict the participation in the open outcry auction to those bidders whose written proposals are at most 20%

(twenty per cent) greater than the value of the best proposal.

§ 2 The assessment of technical proposals, for purposes of qualification or bid appraisal, shall be conducted by a motivated act, based on requirements, parameters and indicators that are related to the scope of the contract, clearly and objectively defined in the invitation to tender.

Art. 13. The invitation to tender may allow a reverse tendering procedure, in which the bid appraisal stage precedes the qualifying stage. In this case:

I - after the bid appraisal, the envelope with the qualification documents from the bidder who made the best offer shall be opened, in order to verify compliance with the requirements established in the invitation to tender;

II - after compliance with the requirements of the invitation to tender has been attested, the bidder who made the best offer shall be declared winner;

III - if the bidder who made the best offer is not qualified, the qualification documents of the second best proposal shall be examined, and so forth, until a classified bidder complies with the requirements established in the invitation to tender;

IV - upon announcement of the final result of the tendering process, the contract shall be awarded to the winner, in accordance with the technical and economic conditions proposed.

Chapter VI

PROVISIONS APPLICABLE TO THE FEDERAL GOVERNMENT

Art. 14. An inter-ministerial council to manage the federal public-private partnerships program shall be established, by decree, with the following responsibilities:

I - definition of priority services to be procured in the public-private partnership format;

II - establishment of procurement procedures;

III - authorization for opening tendering processes and approval of invitations to tender;

IV - evaluation of contract performance reports.

§ 1 The council mentioned in the *caput* of this article shall be composed by nominated representatives and their substitutes from each of the following ministries:

I - Ministry of Planning, Budget and Management, which shall be responsible for coordinating the activities;

II - Ministry of Finance;

III - Civil Cabinet of the Presidency.

§ 2 A representative of the body of the Public Administration whose technical field is directly related to the partnership contract under analysis shall take part in the meetings of the council described in the *caput* of this article.

§ 3 Decisions made by the council in relation to contracting public-private partnerships shall be based on prior and sound statements formulated by:

I - the Ministry of Planning, Budget and Management, with regard to the merit of the project;

II - the Ministry of Finance, with regard to the viability of granting public payment guarantees and their form, relative to the risks for the National Treasury and compliance with the limit set forth in art. 22 of this Act.

§ 4 For carrying out its functions, the council described in the *caput* of this article may create a technical support structure staffed with representatives of public institutions.

§ 5 The council described in the *caput* of this article shall present to the National Congress and to the Federal Audit Office, on an annual basis, reports on the performance of the public-private partnership contracts.

§ 6 In order to comply with the provisions of item V of art. 4 of this Act, with the exception of information classified as confidential, the reports described in § 5 of this article shall be made available to the public on a public network for data transmission.

Art. 15. The Ministries and Regulatory Agencies shall be responsible, within their respective jurisdictions, for submitting the invitation to tender to the inter-ministerial council, carrying out the tendering process, monitoring and controlling the public-private partnership contracts.

Sole paragraph. The Ministries and Regulatory Agencies shall present to the body described in the *caput* of art. 14 of this Act, every six months, detailed reports on the performance of the public-private partnership contracts, as defined by regulation.

Art. 16. The Federal Government and its executive agencies are hereby authorized to participate, up to a total limit of R\$ 6,000,000,000.00 (six billion reais), in a Public-Private Partnership Guarantee Fund - FGP, set up with the purpose of guaranteeing the Federal Government's payment obligations under partnerships made according to the provisions of this Act.

§ 1 The FGP shall possess its own assets, separate from its quotaholders', and have the stand to sue and be sued.

§ 2 The FGP capital shall be formed by assets and rights transferred by its quotaholders and by the proceeds generated from its administration.

§ 3 The assets and rights to be transferred to the FGP shall be previously evaluated by experts, which

shall indicate the valuation criteria and shall include detailed documentation regarding the assets evaluated.

§ 4 Payment for subscriptions of quotas in the FGP may be made in cash, government bonds, real estate, equipment and other assets, including shares of government-owned enterprises that exceed the amount necessary for the maintenance of public control .

§ 5 The FGP shall meet its obligations with its own assets so that its quotaholders shall not be responsible for meeting any of the Fund's obligations, except when there are subscriptions not fully paid in, in which case the quotaholders shall be liable for the unpaid subscription.

§ 6 Government tender regulations do not apply to the subscription of quotas paid with the assets referred to in § 4 of this article. The transfer of assets shall be proposed by the Minister of Finance and approved by the President of the Republic.

§ 7 The transfer to the FGP of assets with special use or common use shall be authorized on an individual basis.

Art. 17. The FGP shall be created, administered, managed and represented by a financial institution controlled by the Federal Government, subject to the rules referred to in item XXII of art. 4 of Act 4,595, dated December 13th, 1964.

§ 1 The by-laws and regulations of the FGP shall be approved by the board of quotaholders.

§ 2 The representation of the Federal Government at the board of quotaholders shall be in accordance with item V of art. 10 of Decree-Act 147, dated February 3rd, 1967.

§ 3 The financial institution shall be responsible for the management and disposal of the assets and assignment of rights of the FGP, while promoting its profitability and liquidity.

Art. 18. The guarantees of the FGP to each quotaholder shall be made in proportion to the value of his quotas. Taking into account the guarantees already granted and other obligations, the FGP shall not provide guarantees with a net present value that exceeds the total value of its assets.

§ 1 The guarantee shall be granted as approved by the board of quotaholders, in the following forms:

I - contractual guarantee;

II - attachment of FGP's assets or assignment of its rights, without transfer of possession of the assets and rights before the execution of the guarantee;

III - mortgage of the FGP's real estate;

IV - fiduciary transfer of ownership, remaining the possession of the assets, until execution of the guarantees, with the FGP or with a trustee contracted by the Fund;

V - other contracts that produce the effect of a guarantee, provided they do not transfer the ownership or direct possession of the FGP assets to the private partner before the execution of the guarantee;

VI - trust funds settled by the FGP to provide guarantees to the private partners.

§ 2 The FGP may provide counter-guarantees to insurance companies, financial institutions and international organizations that guarantee the public payments in public-private partnership contracts.

§ 3 The payment by the public authority of each debt installment guaranteed by the FGP shall result in a proportionate reduction of the guarantee.

§ 4 When the public partner fails to pay for invoices that have already been accepted, the private partner may execute the guarantees 45 (forty-five) days after the date of maturity.

§ 5 When the public partner fails to pay for invoices that have not yet been accepted nor have been expressly rejected, the private partner may execute the guarantee 90 (ninety) days passing maturity.

§ 6 The payments by the FGP to the private partner will entail subrogation of the credits of the private partner against the public partner.

§ 7 In case of FGP default, the FGP assets may be submitted to seizure in order to fulfil its obligations.

Art. 19 The FGP shall not pay any dividends to its quotaholders. The quotaholders shall have the right to make full or partial redemptions of quotas, corresponding to equity as yet unused for the concession of guarantees. The redemption price shall be determined based on the equity value of the FGP on the date of redemption.

Art. 20. The dissolution of the FGP, as decided by the board of quotaholders, shall be subject to prior settlement in full of the guaranteed obligations or the release of guarantees by the creditors.

Sole paragraph. After the dissolution of the FGP, its equity shall be divided among the quotaholders, based on the equity position of the Fund on the date of dissolution.

Art. 21. The FGP may set up trust funds to provide guarantees to specific private partners. The trust funds assets will not be subject to search and seizure resulting from other obligations of the FGP.

Sole paragraph. The constitution of trust funds shall be registered by a Real Estate Notary in the case of real estate or by a Regular Public Notary in the case of other types of assets.

Art. 22. The Federal Government may enter into a public-private partnership contract only when the sum of the current expenditures derived from the partnership contracts already signed has not

exceeded, in the previous year, 1% (one per cent) of the net current revenue of the fiscal year, and the annual expenditures of the contracts in effect, in the 10 (ten) subsequent years, do not exceed 1% (one per cent) of the net current revenue forecast for the respective fiscal years.

Chapter VII FINAL PROVISIONS

Art. 23. The Federal Government is authorized to grant incentives, within the scope of the Program of Incentives for Implementing Projects of Social Interest (*Programa de Incentivo à Implementação de Projetos de Interesse Social - PIPS*), established by Act 10,735, dated September 11th, 2003, for the financial assets in investment funds, created by financial institutions, which entail credit rights in public-private partnership contracts.

Art. 24. The National Monetary Council shall establish, in accordance with the appropriate legislation, guidelines for the concession of credit facilities for financing public-private partnership projects, as well as for the participation of pension funds in funding partnership contracts.

Art. 25. The National Treasury Office shall publish, in accordance with the appropriate legislation, general norms regarding public accounts in relation to public-private partnership contracts.

Art. 26. The item I of § 1 of art. 56 of Act 8666, dated June 21st, 1993, shall be in effect with the following wording:

"Art. 56 ...

§ 1 ...

I - collateral in cash or government bonds, which must have been issued in book entry form, by registration in a central system for settlement and custody authorized by the Central Bank of Brazil and appraised at their economic value, as defined by the Ministry of Finance;

..." (NR)

Art. 27. Credit operations made by state-owned enterprises or by corporations with mixed public and private capital controlled by the Federal Government shall not exceed 70% (seventy per cent) of the total sources of funds of the special purpose company. For areas in the North, Northeast and Central-West regions where the Human Development Index - HDI is below the national average, this amount shall not exceed 80% (eighty per cent).

§ 1 A limit of 80% of the total sources of funds of the special purpose company, or 90% for areas in the North, Northeast and Central-West regions where the Human Development Index - HDI is below the national average, must be applied for credit

operations or capital contributions made cumulatively by:

I - pension funds;

II - state-owned enterprises or corporations with mixed public and private capital controlled by the Federal Government.

§ 2 In the provisions of this article, sources of funds shall be understood as credit operations or capital contributions to the special purpose company.

Art. 28. The Federal Government may not grant guarantees in credit operations or make voluntary transfers to the States, Federal District and Municipalities if the sum of current expenditures derived from the partnerships already contracted by these authorities has exceeded, in the previous year, 1% (one per cent) of the net current revenue for the fiscal year, or if the annual expenditures of the contracts in effect, in the 10 (ten) subsequent years, exceed 1% (one per cent) of the net current revenue forecast for the respective fiscal years.

§ 1 The States, Federal District and Municipalities that procure public-private partnerships must send to the Senate House and to the National Treasury Office, prior to contracting, the necessary information for compliance with the provisions of the *caput* of this article.

§ 2 For complying with the limits established in the *caput* of this article, the calculation shall include expenditures derived from partnerships contracted by the direct Public Administration, agencies, public foundations, state-owned enterprises, corporations with mixed public and private capital and other bodies directly or indirectly controlled by those entities.

§ 3 (OVERRULED)

Art. 29. The penalties provided for in Decree-Act 2848, dated December 7th, 1940 - Criminal Code, in Act 8429, dated June 2nd, 1992 - Administrative Misconduct Act, in Act 10,028, dated October 19th, 2000 - Fiscal Crimes Act, in Decree-Act 201, dated February 27th, 1967, and in Act 1,079, dated April 10th, 1950, shall apply to public-private partnerships, notwithstanding the financial penalties provided for in contract.

Art. 30. This Act shall be in effect from the date of its publication.

Brasilia, December 30th, 2004.