

## NEW BRAZILIAN WATER AND SANITATION REGULATORY FRAMEWORK

This briefing offers a description of the main aspects of the new regulatory framework for the water and sanitation sector in Brazil.

On June 24, 2020, the Brazilian Senate approved the new regulatory framework for the water and sanitation sector (the “**New Framework**”). On July 15, 2020, President Bolsonaro enacted the law but vetoed several sections of the bill. The vetoes are now subject to Congressional review and Congress can vote to disregard the vetoes and enact the original provisions in their entirety.

One of the main outcomes expected from the New Framework is an increase in opportunities for privatization and private investment in the water and sanitation sector in Brazil. Unlike all other Brazilian infrastructure sectors, the water and sanitation sector has not yet been fully opened to private investment. The New Framework sets the goal of universal coverage of sanitation services in Brazil by 2033. Achieving this goal is expected to require investments in the range of R\$500 billion (approximately US\$90 billion) to R\$700 billion (approximately US\$130 billion).

### THE BRAZILIAN WATER AND SANITATION MARKET

Brazil considers water and sanitation as essential services. However, approximately 35 million Brazilians do not have access to potable water, and about 100 million do not have access to sanitation infrastructure. The regions with the lowest coverage levels are the North and Northeast of the country.

Although the current regulatory framework does not prevent the participation of the private sector, state-owned water and sanitation companies (“**SOWSCs**”) cover about 94% of Brazilian cities while private companies cover only 6%. The changes proposed by the New Framework should lead to a reduction in the participation of SOWSCs and an increase in the coverage provided by private companies. However, as in any other sector, it will be essential for state and municipal governments to properly structure the projects to attract private companies and their finance providers to participate.

## **SELECTED CONSIDERATIONS OF THE NEW REGULATORY FRAMEWORK**

### **Tender processes**

Currently, municipal governments sign agreements with the relevant SOWSC under a framework agreement ("*Contrato de Programa*") between the state government and the SOWSC without engaging in a competitive process. Under the New Framework, municipal governments will be required to implement tender processes in which SOWSCs will compete against qualifying private companies.

### **Universalization Goals**

Although the framework sets goals for universal access to water and sanitation to be accomplished by 2033, this deadline may be postponed by up to seven years if it is proven technically or financially unfeasible. Under the New Framework, by 2033, 99% of the population is expected to have access to potable water and 90% to sanitation infrastructure, as determined by the 2013 National Basic Sanitation Plan ("*Plano Nacional de Saneamento Básico - Plansab*").

SOWSCs and private companies must commit under framework agreements to be amended pursuant to the terms of the New Framework or new concession agreements, as applicable, to the universalization goals outlined in the New Framework.

Existing framework agreements will have to be amended prior to March 31, 2022 to establish the universalization goals which include, among others, the: (i) expansion of water distribution and sanitation networks, (ii) reduction of loss in the distribution of potable water, (iii) quality of the services, (iv) efficiency and rational use of water, energy and other natural resources, and (v) the reuse of sewage and rainwater. New concession agreements will also be required to include these targets. In addition, SOWSCs and private companies bidding for projects will be required to demonstrate financial viability without material subsidies or transfers from the relevant government.

### **Offering of block regions**

One of the challenges presented by the privatization of essential services is ensuring that private companies will continue to provide or expand services in cities or regions where the performance of such services does not meet their profitability requirements. As a solution, the New Framework enables the tendering of projects pairing municipalities or regions where the performance of the services is expected to be profitable with smaller, isolated or impoverished jurisdictions. The municipalities are not required to participate in block offerings but they are incentivized to do so because, by themselves, they could prove to be less economically attractive to private companies when compared to a block of municipalities or regions and the Federal Government will not implement measures to mitigate the consequences of the capital allocation decisions made by private companies. Stand-alone municipalities and block regions will have to compete, on equal terms, for the allocation of water and sanitation investments from the Federal Government.

## **Creation of Regulatory Standards**

In order to ensure consistency of regulatory standards across Brazil, the National Water Agency (“*Agência Nacional de Águas*”, or “**ANA**”) will now be responsible for creating national performance standards.

Among other duties, ANA will be responsible for standardizing: (i) the quality and efficiency requirements applicable to the supply, maintenance and operation of basic sanitation systems, (ii) the methodology to determine tariffs, and (iii) the scope of agreements with the SOWSCs and private companies.

The New Framework incentivizes the decentralized sub-national regulatory agencies at state, municipal, intermunicipal and district levels to follow ANA's guidelines and standards when implementing regulatory requirements.

## **Environmental licensing**

Municipal governments will be responsible for environmental licensing of water and sanitation projects. If there is no agency of the municipal government that can take responsibility for the process of granting licenses in any specific area, the relevant state agency will perform this responsibility.

## **Decommissioning of wasteyards**

The law that was in force until the New Framework was enacted, established that wasteyards had to be decommissioned by 2014. The New Framework now sets December 31, 2020 as the new deadline. The deadline will not apply to municipal governments with intercity solid waste plans or a municipal plan for integrated solid waste management. In such cases, the deadlines will vary from August 2021 to August 2024, depending on the conditions of each municipal government.

## **SELECTED VETOES SUBJECT TO FURTHER REVIEW BY CONGRESS**

### **Extension of existing framework agreements**

The Executive branch vetoed a provision in the bill approved in the Senate that established that (a) existing framework agreements could be extended for up to 30 years and (b) certain *de facto* situations (services being rendered without a contract or after the expiration of a contract) be recognized as framework agreements and extended for up to 30 years. In each case, the extensions would need to be agreed prior to March 31, 2022.

As a result of the presidential veto: (a) only a SOWSC may, in the context of a change of control transaction resulting from a privatization of its share capital, negotiate, among other terms and conditions, an extension of the term of its contracts, (b) municipal governments will be required to launch tender processes to replace the existing contracts with SOWSCs that have not been privatized when those contracts expire, and (c) it is not clear what will happen with the *de facto* situations. In all cases, existing contracts have to adapt to the requirements of the New Framework.

### **Compensation for non-amortized/depreciated assets**

If in the context of a change of control of a SOWSC, a company were to propose further amendments to the agreement entered into with a municipal government

(i.e., changes in the terms and maturity date, purpose of the agreement, or other material clauses), the municipal government could reject the changes and take over the performance of the services by compensating the SOWSC for the non-amortized/depreciated assets. Under the New Framework, the assets which would have been taken into consideration for purposes of the compensation payment are those that have been funded by the company's earnings or through financings incurred to acquire those assets. However, as a result of the veto this calculation will be made pursuant to the principles set forth in the existing legislation (Concessions Law N. 8.987/95).

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