

Brazilian New Basic Sanitation Law: The Reform and Its Implication for New Investments

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Abstract: *This article discusses some of the most recent changes of the Brazilian Basic Sanitation Law and how these are relevant to make the sanitation services sector more attractive to private investors and assure the required coverage and quality.*

Brazil's Reality and the New Sanitation Framework

Nowadays, basic sanitation services, such as water supply, sewage collection and treatment, are limited and inadequately provided in Brazil, reaching only approximately one half of the population. Low investment levels are part of the reason why the service isn't widely offered. In 2017, investment in basic sanitation was down to amounts invested in 2011—US\$2 billion—while the cost to universalize access for all sanitation services (water, sewage, waste and drainage) is estimated at US\$94.3 billion, in the period from 2014 to 2033, according to the Brazilian National Basic Sanitation Plan, thus requiring an average yearly investment of approximately US\$3.3 billion.

The attempts to implement changes in the regulatory framework of the sector were discussed over many years,

seeking a true measure of legal modernization. A substantial part of the concern was focused on making the sector more attractive to private investment and to reduce the presence of state-owned companies.

Recently, the Brazilian National Congress approved Law n. 4.162/2019, which was widely celebrated. The bill was approved by President Jair Bolsonaro, after he presented 17 vetoes to the text, and sanctioned as Law n. 14.026/2020 ("New Sanitation Framework" or "Sanitation Law"). The Sanitation Law changed the sector's service provision rules and will have significant impact on the granting of new concessions and regulatory modernization measures, among others.

The End of the State Monopoly

A major change in the Sanitation Law is the prohibition of new "Program Contracts" (*Contratos Programa*) for the provision of water supply and sewage services. Program Contracts were used to allow for state-owned companies to provide services in a certain municipality without a bidding process, preventing the granting of the concession to a private company, as Program Contracts could only be entered into with state-owned

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companies. This legal provision was a bottleneck. As a result, nowadays only approximately 8 percent of the sanitation services are provided by private companies in Brazil.

The prohibition of new Program Contracts makes competition the main rule. State-owned companies are allowed to participate in the bidding procedures together with private companies under equal conditions to provide water supply and sewage services. The update also means that services will necessarily be provided through a concession contract after a public bidding process.

As a transition clause, the Sanitation Law allows ongoing Program Contracts to remain in force until their expiration if the state-owned companies are able to prove their economic and financial capability as service providers through either their own resources or third-party financing. The main criteria is the capability to grant universal access of water and sewage services in the relevant areas under the contract by December 31, 2033. If the state-owned company cannot provide evidence of its capabilities to achieve that goal, the ongoing Program Contract shall be terminated, and the award of the concession will be subject to a public bidding procedure.

A National Regulator

Previously, the sanitation services sector was regulated only at the city level. The lack of standardization and basic rules, including tariff revision criteria, indemnity, inspection, goals and contractual obligations, burdened transaction costs and discouraged the entry of new private players in the sector, given the greater degree of insecurity and uncertainty.

One of the premises of the New Sanitation Framework, as indicated above, is the need to expand partnerships with the private sector to achieve the ambitious goal of granting universal access. Measures to improve and establish standardized regulation are one of the main market criticisms. As a result, the Sanitation Law establishes that the Brazilian National Water Agency (“NWA” or “ANA” in Portuguese) shall establish regulatory guidelines to be followed by the state and city regulatory agencies. Allocation of federal resources will be conditioned on compliance with the guidelines established by ANA.

Contract’s Minimum Content

Another significant change brought by the New Sanitation Framework is certain mandatory essential contractual provisions. In addition to those set forth in art. 23 of Law n. 8.987/1995, which introduced the concession regime in the Brazilian legal system, basic sanitation service provision contracts shall contain: (i) targets: service expansion, reduction of non-revenue water, quality of service provision, efficiency and rational use of water, electricity and other natural resources, among others; (ii) extraordinary revenues: potential sources of alternative, complementary or accessory revenues, as well as those arising from associated projects, including, among others, sale and use of sanitary effluents for water reuse; (iii) indemnification: for non-amortized investments in reversible assets: methodology for calculation of indemnification value; and (iv) clear risk allocation: risk-sharing among the parties, including force majeure, acts of God and extraordinary events with economic consequences.

This minimum content actually provides another level of certainty and expectation about the concession contract, bringing greater certainty to the private investor.

Regionalized Provision

The Sanitation Law establishes a broader legal definition regarding the provision of regionalized services as an integrated provision of one or more components of basic sanitation services in a region whose territory covers more than one city. The goal of the measure is to assure the provision of sanitation services in smaller cities by compensating costs by joining other municipalities for an economy of scale strategy.

The regionalized provision can be structured through three main compositions: (i) metropolitan region, urban cluster or micro region: a unit created by each state under a law, by grouping adjacent municipalities; (ii) regional unit of basic sanitation: a unit created by each state under a law, by the grouping of municipalities that do not need to be contiguous, to adequately meet the requirements of hygiene and public health or to ensure economic and technical feasibility to less favored municipalities; and (iii) reference block: grouping of municipalities that do not need to be contiguous,

established by the federal government, and if the government does not, it can be formally created by means of associated management of service holders (e.g., cooperation agreements and public consortium). Another measure adopted by the New Sanitation Law is granting federal funding priority to regional blocks, when economic and financial sustainability of the service cannot be ensured solely through the collection of tariffs or taxes, even after grouping with other state's municipalities.

Conclusion

It is expected that the Brazilian New Sanitation Framework will increase private investment in Brazil due to the implemented changes, such as setting equal grounds of competition among state-owned and private companies and signaling government's interest in improving legal conditions for contracts focused on infrastructure. Finally, the Sanitation Law recognizes how partnerships with the private sector will enable the achievement of public interest goals.

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