

EXECUTIVE SUMMARY

THE EXTENSION OF POWER DISTRIBUTION CONCESSIONS

ANALYSIS OF THE BRAZILIAN CASE FROM THE
PERSPECTIVE OF LATIN AMERICAN COUNTRIES



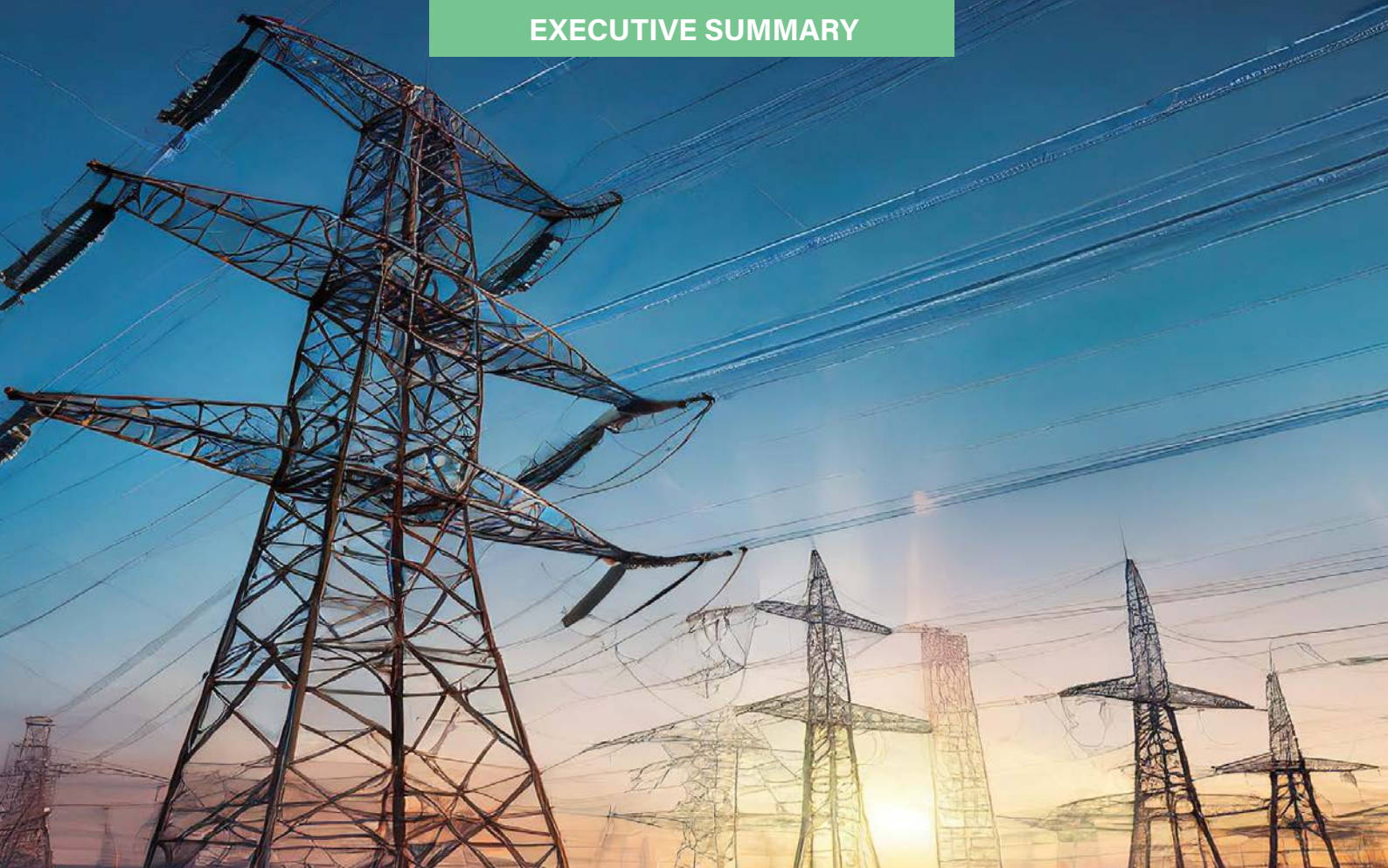


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The electric distribution faces the challenge of meeting growing electrification demands and integrating distributed energy resources. The design of contractual models should promote supply quality, consumer satisfaction, economic-financial balance, and sustainable sector development. Flexibility is also essential to adapt to the evolving challenges of the energy transition.

By 2025, the contracts for 20 Brazilian distribution concessions, privatized after 1995, will expire. Legal and contractual provisions allow for the possibility of contract extensions, subject to assessment by the Ministry of Mines and Energy (MME) based on service compliance.

To contribute to the ongoing debate in Brazil regarding the renewal model for concessions, this document describes various regulatory distribution models existing in Latin America and Europe.

In Latin American electricity markets, organizational patterns in the electric sector

exhibit similarities. For distribution activities, contracts have been established with private capital since the 1980s and 1990s. These contracts consider the private agent's capacity for investments, facility operation, and provision of quality services.

Several countries do not impose a fixed term for electric distribution service (such as Chile, Colombia, and Peru). When they do, the term tends to be considerably long (as seen in Argentina and Guatemala). This approach reflects continuous price regulation and ongoing monitoring of service quality.

Table 1. Strategic Vision for the Renewal of Power Distribution Service in ADELAT Member Countries.

EXECUTIVE SUMMARY							
CRITERION	ARGENTINA	BRASIL	CHILE	COLOMBIA	ECUADOR	GUATEMALA	PERU
Contracting Model	Concession	Concession	Concession	Authorization	Authorization	Authorization	Concession
Term and Duration	95 years	30 years	Indefinite term for old concessions and temporary term for new operators.	Indefinite term	Term established in the qualification title.	50 years	Indefinite term
Extension Conditions	A management period is established every 10 years (currently suspended).	It can be extended for an additional 30 years.	Not applicable to old concessions, and there is no provision for extension for new operators.	There are no extensions, as the term is indefinite.	It can be extended if it is convenient for the State's interest.	No provision for extensions	There are no extensions, as the term is indefinite.
Contract Obligations	Factors considered include regulated tariffs, quality, and consumer service.	Factors considered include regulated tariffs, quality, safety, asset control, and consumer service.	Factors considered include regulated tariffs, quality, third-party access, investment plan, and consumer service.	Application of regulated rates for an indefinite term, quality, investment plan, consumer care, energy loss prevention.	Application of regulated rates, system expansion, quality, consumer care.	Application of regulated rates, system maintenance, third-party access.	Application of regulated rates, system expansion, quality, consumer care, third-party access.
Contract Suspension	When annual penalties exceed 20% of the DSO annual income.	When it does not meet quality and economic-financial management requirements.	When less than 2/3 of the investment plan works are completed.	When it does not comply with regulatory requirements.	Cases according to LOSPEE - "Termination of the operating authorization."	When annual penalties exceed 20% of annual revenue, if the DSO denies third-party access permission, if poor service quality is verified, or by mutual agreement.	When requirements regarding quality, supply of regulated demand, or payment to generators are not met.
Compensation for Assets	Through the sale of majority shares deducted from debts.	Determined by calculating the Net Regulatory Remuneration Base (not depreciated).	Determined by calculating the Net Regulatory Remuneration Base.	Determined by calculating the Net Regulatory Remuneration Base.	No compensation is foreseen because it concerns the State itself.	Through the valuation of auctioned assets minus incurred costs.	Auctioned assets are valued, and the incurred costs to maintain operations are subtracted.



1.1. ARGENTINA

Since 1992, electricity distribution has been carried out through public concessions, valid for 95 years, with the same duration applying to all distributors. However, the concession term can be divided into several management periods: the first lasting 15 years, followed by subsequent 10-year periods. Only at the end of each period can a change in shareholding control occur, subject to authorization from the Granting Authority. However, due to macroeconomic conditions and emergency regulations, this mechanism is currently suspended.

The contract can be extended once for 10 years upon request from the distributor, at least 18 months before the expiration date. After the 10-year extension, a new auction takes place, during which: (i) the regulator specifies the tariff provisions that will apply for the next 5 years, (ii) the current distribution operator has the opportunity to participate in the new auction, and (iii) the regulator designates a supervisor responsible for ensuring information flows during the auction and asset transfer process for a two-year period—one year before and one year after the auction.

When a new bidder wins the auction, the current

operator receives compensation for the assets from the new concessionaire. Since the majority shares of the distributor are guaranteed by the State, it executes this guarantee and sells those shares. The proceeds from the sale are then deducted from the concessionaire's debts. Contract termination is possible if the total annual penalties exceed 20% of annual revenues.



1.2. CHILE

Since 1988, electricity distribution has operated under the model of public concession, and new concessions can be assigned to areas already granted to a company. The typical term of these concessions is indefinite, meaning there are no specific terms for extensions. However, the law also allows for the implementation of temporary concessions. The concessionaire can transfer the contract to third parties with prior authorization from the Ministry of Energy and the National Energy Commission. This transfer must demonstrate economic efficiency in the sales process without adversely affecting consumer tariffs.

The concession may be revoked if the concessionaire fails to comply with the contractual provisions or does not complete at least two-thirds of the investment plan within the established

timeframe (excluding cases of force majeure or accidental circumstances). Revocation can also occur due to non-compliance with service quality standards, although the concessionaire has the right to request additional time for rectification. Additionally, if the new concessionaire fails to comply with the General Law within 6 months of asset transfer, the concession may be revoked.

In cases of contractual termination, the Granting Authority must identify a provisional service executor. If the concession is withdrawn, the President of the Republic will initiate a new auction to award the service, defining an Investment Plan. To participate in the auction, companies must provide a guarantee bond, which cannot be less than 10% of the value of the assets and rights to be acquired. From the amount obtained through the award, the incurred costs will be deducted, and the remaining balance will be allocated to the former concessionaire.



1.3. COLOMBIA

Electricity distribution in Colombia do not operate under a concession regime, so there is no specific award procedure. Both private and state-owned companies participate in the process overseen by the Energy and Gas Regulatory Commission (CREG). In each case, CREG authorizes the distributor to apply charges within the commercialization market where it operates. These authorizations are based on a general methodology for remunerating distribution activities, which is reviewed every five years.

Unlike traditional concessions, there are no specific terms for extensions or contractual suspension. The validity of the distribution service continues as long as the company operates distribution assets within the commercialization market.

The tariff for service provision includes both positive and negative incentives. These aim to encourage investment and improve quality indicators. The Superintendence of Utility Services oversees and controls service quality. It has the authority to intervene in companies providing distribution services.



1.4. ECUADOR

The operation regime for electricity distribution depends on the characteristics of each company. For public and mixed companies, an operating authorization is granted by the Ministry of Energy and Mines. In contrast, private and community-based enterprises must adhere to concession contracts. Currently, only public companies hold the enabling titles granted by the Granting Authority. The update of their respective operating authorizations is managed without urgency, as the lack of updating does not impact the distributor's operations.

Each distributor is obligated to expand the system within its exclusive geographical area, following the Ministry of Energy and Mines' planning. Additionally, distributors must comply with quality levels according to regulations set by the Agency for Regulation and Control of Energy and Non-Renewable Natural Resources (ARCERNNR).

The operating authorization can be terminated due to expiration, mutual agreement, resignation, dissolution, liquidation, or bankruptcy of the holder, among other reasons. The Ministry may also declare expiration if the authorized investments are unjustifiably not carried out. In such cases, no compensation is foreseen for the concessionaire, as it concerns the State itself.



1.5. GUATEMALA

Electricity distribution in Guatemala operates under an authorization granted by the Ministry of Energy and Mines (MEM). This authorization is subsequently formalized through a contract between the parties. The term of this contract cannot exceed fifty (50) years, and it must not have an exclusive character, allowing third parties to compete with the awardee in the same service.

Three major private capital distributors and 16 small municipal companies handle electricity distribution in Guatemala. The Ministry granted authorization to the major distributors in 1998 with the aim of disincorporating them from the State.

The authorization contract can be terminated if penalties exceed 20% of revenues, or if evidence shows inadequate service provision (to be verified by the National Electric Energy Commission), among other grounds for termination. In case of authorization termination, the distributor must ensure service continuity and the Ministry has the right to temporarily possess the distributor until rights and assets are auctioned. The proceeds from the auction will be deducted from incurred expenses and outstanding sums owed by the distributor. The remaining balance will be delivered to the distributor, who commits not to oppose the public auction.

The caducity of the concession occurs for various reasons: (i) non-compliance with quality standards specified in the contract, (ii) Failure to guarantee demand from regulated users for the next 24 months, and (iii) non-payment to generating companies for energy supply. In such cases, the caducity of the concession is issued by a resolution from the Minister of Energy and Mines. Provisional administrative intervention ensures continuity of operation.

When the concession expires, the distributor's assets are auctioned through a public process. The auction proceeds cover incurred expenses for maintaining concession operations, and the remaining balance is delivered to the previous concessionaire.



1.6. PERÚ

Electricity distribution operates under a regime of "definitive concessions" granted for an indefinite period, subject to compliance with obligations established in the Electric Concessions Law. Therefore, no conditions for concessions' extension are foreseen.



1.7. EUROPE

Despite European Union provisions not imposing the application of a concession system for the distribution activity or the use of public tender procedures for its allocation, the most widespread model in Europe are the indefinite concessions/authorizations or those with an option for renewal. In these models, a DSO has a presence in most of the national territory. The “indefinite” model is used in Spain, Greece, the United Kingdom, Croatia, Finland, and Austria, while the option for renewal is implemented in France, Portugal, Sweden, and Romania.

The term or structure of the concession regime have undergone modifications in some countries. In France, concession contracts have been renegotiated, resulting in consolidation and extension of their duration, which currently ranges between 20 and 30 years; moreover, for the municipality of Paris, renewal contract includes conditions associated with climate and

energy transition objectives. In Portugal, there is a unique concession assigned at national level for medium and high voltage electricity distribution that, in 2009, was extended until 2044.

02

ELECTRICITY DISTRIBUTION CONCESSIONS IN BRAZIL

Brazil stands out for achieving universal access to electricity, as evidenced by the results of the PNAD (National Household Sample Survey) conducted by IBGE on General Characteristics of Households and Inhabitants in 2022. The survey revealed that almost all households in the country (99.8%) had access to electricity, either through the general grid (99.4%) or an alternative source (0.4%). This access is consistent across all regions of the country, with minimal variation of only 0.8% between the North Region (99.1%) and the Southeast, South, and Central-West Regions (99.9%).

Access to electricity significantly surpasses coverage for other services. In 2022, 86.0% of households had direct waste collection services, while 85.5% relied on the general water distribution network as their main water supply source. Additionally, 69.5% of households had sewerage or a septic tank connected to the general network.

This underscores the crucial role of electricity distribution and the effectivity of Brazilian energy agents in ensuring satisfactory supply coverage. The development of distribution activities was based on network expansion and the integration of new consumer units into the system. However, currently, electricity distribution faces the challenge of meeting the growing demand for electrification and the incorporation of distributed energy resources.

This chapter discusses the renewal of electricity distribution concessions in Brazil, by presenting the historical context of the Brazilian contractual regime and the proposed guidelines by the Ministry of Mines and Energy for the ongoing process.

2.1. HISTORICAL CONTEXT OF DISTRIBUTION CONCESSIONS IN BRAZIL

There are two groups of distribution concessions in Brazil::

(i) The first group, comprising state-owned and small private concessionaires, had its concession contract extended for 20 years in 1995, which was further renewed for an additional 30 years in 2015. In both cases, the renewal occurred without any financial counterpart; compliance with economic-financial and quality clauses was the only requirement.

(ii) The second group includes concessionaires that were privatized through auctions held between 1995 and 2001, with a 30-year contract term. For these companies, the acquisition of the exploitation rights was done through bidding.

Starting in 2025, the contracts for 20 electricity distribution concessions from the second group will expire. In 2023, the Ministry of Mines and Energy (MME) initiated the process of establishing guidelines for the extension of these concessions. The distributors in question, along with other stakeholders, have expressed specific positions and reservations regarding the proposal. The key points of this debate are summarized below.

2.1.**Minimum Criteria for Concession Renewal**

The Ministry of Mines and Energy (MME) has presented two criteria that distribution companies must meet to enable the renewal of their concessions. The first criterion relates to supply quality based on indicators of frequency and average duration of interruptions (FECi and DECI). The second criterion refers to the economic-financial management efficiency of the concession (EBITDA greater than the sum of QRR - Regulatory Reintegration Quota - and Debt Interest). These criteria, in addition to being included in the sector's regulation, have already been incorporated into the most recent concession contracts since 2015, and allows for an objective evaluation by the Granting Authority, contributing to an environment of legal certainty and predictability in the sector, as well as preserving equity among distribution companies.

Regarding quality, there are no major controversies within ANEEL, indicating that this norm has adequately fulfilled its role. However, discussions and questions surrounding economic and financial indicators suggest that the experience with these indicators may provide an inadequate view of the concession's condition. Therefore, the economic-financial conditions intender for continuous monitoring of concession sustainability should consider adjustments in their calculation.

The MME also proposes that non-compliance with the established minimum criteria should not be an impediment to the renewal of the concession. Instead, the concessionaire should be required (i) implement an approved recovery and correction plan for identified faults and violations, or (ii) undergo a change in shareholding control, with the new controller demonstrating "technical capacity in managing distribution concessions." While the proposal allows for adaptation of concessionaires, it falls short by not explicitly

including these criteria in the guidelines for analyzing minimum conditions for renewal.

2.2.**Social Counterparties and Financial Resources**

The MME recommends the renewal of concessions to be accompanied by investments in energy efficiency and modernization of distribution networks. These investments should align with an Investment Plan prepared by the concessionaire and approved by the MME. The plan should consider the regional context of each concession and focus on areas such as: (i) energy efficiency programs in public buildings, (ii) energy efficiency in areas with high non-technical losses, (iii) promotion of economic and social development for vulnerable populations through sector-specific actions, (iv) solar panels to reduce energy costs for water tanks and artisanal wells in water-scarce communities, and (v) strengthening the distribution network in specific regions to increase electricity consumption.

Regarding the sources of resources for social counterparties, the MME initially proposed four possibilities: (i) economic surplus of concessionaires, (ii) resources allocated to energy efficiency programs, (iii) other revenues from complementary ancillary activities and fines imposed by distributors for excessive demand and reactive energy, and (iv) surpluses from regulatory capital costs due to tax benefits granted to specific regions.

However, after review, the MME excluded the economic surplus and the regulatory capital cost surplus due to tax benefits, and recognized that charging counterparties based on these resource sources would be inappropriate.

2.3.**Digitization and Modernization of Grids**

The MME emphasizes the digitalization of grids as an aspect to consider in the concession renewal process. However, this topic deserves a separate and detailed discussion regarding its guidelines, and its effects should be perceived equitably and uniformly across all concessions, not just a subset.

Through NT 19, the MME includes a guideline that allows to differentiating the tariff structure based on technical, location, quality, and geographical criteria. Significant disparities among concessions, both within the same concession area and across different areas, reflect differentiated needs within the distribution sector. Therefore, it is essential to consider regional realities and the most urgent demands of each concession, especially given resource constraints for intensive investment demands. Mature concessions require fewer investments in expansion and have more room for grid modernization and digitalization. Conversely, concessions in the development phase necessitate greater investment in expansion, often with increasing costs.

In this context, the evolving role of distributors during the energy transition requires: (i) regulatory adjustments with appropriate incentives to accommodate anticipated changes, balancing tariff moderation, quality improvement, and economic-financial equilibrium; and (ii) greater flexibility in contracts by the Granting Authority, allowing regulations to adapt to technological shifts. A regulatory model capable of addressing the diverse realities of the country, promoting network modernization and digitalization, and grounded in economic resource rationality is essential.

2.4.

Remuneration for Investments in Modern Technologies

The MME proposes incentivizing investments in network and service modernization. Facing this challenges, it is crucial to engage in broad

and coordinated discussions with society about possibilities and pathways that best align with Brazil's realities. The ongoing transformations require incentives that ensure long-term investments in infrastructure. Consequently, they necessitate specific regulatory treatment resulting from a continuous review process. This approach should not impact the defined renewal term for concessions nearing expiration.

Once the continuity of concessions is assured, distributors will have the freedom and security to consider new business models. This will enable them to define their role in the future electric sector. Properly allocating investment needs over time is essential. Recognition and remuneration must be sufficient and timely to ensure sustainable network modernization while balancing business requirements and customer needs.

The Brazilian regulatory model, based on incentive regulation, has facilitated improvements in quality indicators, system expansion, and universal coverage. Simultaneously, it has ensured that productivity gains benefit consumers, creating a virtuous cycle: increased efficiency of companies translates into fair tariffs, allowing continued investment cycles to maintain adequate coverage, reliability, and quality standards.

During contract renewal processes, instability in rules and application criteria can impact negotiation efficiency and the effects of public decisions in the electricity sector. Public interest should guide discussions on the best mechanism to apply, whether for contracts with expiration dates or those with indefinite terms. In the Brazilian context, meeting quality and economic-financial sustainability requirements, renewal emerges as the alternative that best serves public interest. It avoids service interruption or deterioration and minimizes risks associated with potential tenders.

