WATER & SEWAGE REGULATION IN THE STATE OF SAO PAULO: PROBLEMS FOR IMPLEMENTATION?

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1 INTRODUCTION

During the past twenty years, Brazil has been a protagonist of one of the most important processes of economic restructuring in recent history. This changing process has its roots connected to a fiscal crisis that began during the 70’s, after the first oil price shock and the subsequent bankruptcy of the public sector. More specifically when the country’s broken State had to find a way to resume investments in its frail infrastructure sectors, historically Brazil’s bottleneck and a sector where all projects are extremely capital intensive. The answer found to overcome this dilemma was to attract private capital, especially international private capital, to these areas.
This solution materialized itself in a series of Constitutional Amendments that significantly changed the country’s economy. Former public monopolies were reorganized to become utilities provided mainly by private players. Examples are numerous and range from the Telecommunications System (with the presence of international powerhouses like the Spanish Telefónica and the Italian TIM), to land transportation (with many of the most important Brazilian highways now being operated by private sector players) or to the oil industry (with the complete restructuring of the Government-Controlled Company PETROBRÁS, now one of the world’s main players, combined with the introduction of international behemoths like British Petroleum “BP” and ExxonMobil). As a consequence of this somehow successful enterprise, Brazil was highly praised around the world for the economic reform it was sponsoring in its economy. The Federal Government was able to raise as much as US$ 73 billion in cash or assumptions of debt made by the new private players, using such amount to repay its obligations. Moreover, private players were able to significantly raise investments in many of these remodeled sectors, which are now the basis of the country’s strong economic performance.

Even though the country was highly praised, a closer look at this entire process shows that, despite the fact that the general outcome has positive reviews, not all attempts to reorganize infrastructure sectors could be considered great successes. Although the telecommunications industry (now seen as the country’s benchmark for an effective privatization process) managed to increase competition in the sector, producing efficiencies and economies of scale that together are the foundations of this now universally supplied service, the same thing cannot be said about other areas. The electric sector, for example, underwent a partial privatization, where light competition exists in certain areas, such as distribution to big private consumers, but where most investments are either directly made or sponsored by the Brazilian Government (at both the federal and state level).

The reasons to why the outcomes were so diverse are still heavily debated. One of the most well accepted theses holds that the triumph or failure of these procedures is connected to what the doctrine called “timing”, or the course of action taken during the entire privatization process. One of the focuses of the timing argument defends that the complex interaction between the moment when regulatory agency was established and when the auction of the public assets
occurred is central to results observed. This concept can be more easily understood when we analyze the two sectors mentioned above, telecommunications and electricity, as well as the reality of the Brazilian railway sector, another big failure.

As said before, the privatization of Telecom was considered a success. Respecting a straightforward procedure, the Brazilian telecommunications law (law 9.472) enacted in 1997, held, among other things, that the government should no longer be a provider of the telecom services, and act only as a market regulator. Moreover, it created the independent regulatory agency of the sector, Agência Nacional de Telecomunicações – “ANATEL”. Soon after, by decree, the government set goals for the quality and universalization of all services to be rendered by Telecom companies, creating clear obligations for new companies operating in the market. Just after the conclusion of this entire process, when the completed framework was set, the actual auction of the assets happened and private players started operating in the market. What we can perceive is that an extremely important institution, in charge of balancing the private and public interests that are present in these utilities areas explored by private players, ANATEL, was active during most of the design period of the entire operation, especially when contracts were drafted. So, after the privatization was concluded, the agency was regulating contractual obligations it helped to design, and through proceedings it had established prior to the real performing of private parties.

On the other hand, the electric energy market sets the standard for what is not supposed to be done. The law that set the standards for the granting of licenses and the privatization of the sector of public companies was enacted in 1995, the same year the auction of assets started to happen and concession contracts were signed. Only in 1996 law 9.427/96 was enacted, and ANEEL, the sector’s regulatory agency, was duly incorporated and started operating. What can be observed in the experience that follows is that, by being forced to regulate and monitor concession contracts that it did not participate in the making, the agency must negotiate any changes it intends to implement on the sector with the companies. And this bargain is made under extremely unfavorable terms, since the private players have strong and settled positions for their actions, assured by contracts. More than a problem for the agency itself, this process is also highly prejudicial to the system as whole, promoting some visions that the agency deems as negative to the overall welfare, but that cannot be changed without a major change.
in the legal regime, and the disrespect of the contracts celebrated, an arbitrary action that is proscribed by almost all the literature studying the area.

The same course of action can be seen in the railway sector, in which many of the concession contracts were signed for terms of 30 years, prior to the incorporation of ANTT, the federal independent regulatory agency for the sector (established in 2001 by law 10.233). Particularly prejudicial terms of these contracts are related to the fact that they do not have provisions regarding the agreements for rights of passage or mutual traffic of the railways. This creates incentives for the companies, vertically integrated, to act as monopolists and limit the access of competitors to their infrastructure, undermining the development of the sector as a whole and of the economy, which is still greatly dependent on the cost-ineffective highway transportation system. When considering changes in such a sector, a regulator must always face the prospect of long and costly renegotiations of the concession contracts against private parties that have huge disincentives to agree on new terms, since the ones already in place maximize their monopoly profits.

All these considerations about timing and privatization design bring us to a more recent scenario. In 2007, the Water and Sanitation ("W&S") industry was significantly modified by the enactment of law 11.445/07, which revolutionized to the most needy and underfunded infrastructure sector of the Brazilian economy. The law introduced the requirement that all concessions have formal contracts between the conceding power (the municipalities and the operating companies. Aside from this, the new law also created the obligation that all contracts be regulated and monitored by an independent regulatory agency.

Even though all these changes must be praised, as they promote development in a precarious and crucial sector of the country, this small study of the Brazilian privatization process exposes the problems that may arise due to the fact that regulatory agencies are not formal parties in the concession negotiations between municipalities and service providers. Under the frame created by the recent law, only after a contract has been signed, municipalities celebrate a formal agreement with the agency, expressly delegating their regulatory and supervisory powers. What we see, then, is that the structuring of the system obliges the regulatory agency to perform its activities regulating a contract designed by third parties, similar to what can be seen in the railway and electric energy sectors.
This paper analyzes three very different concession contracts executed between the Municipalities of Borá, Sao José dos Campos and Sao Paulo, all members of the State of Sao Paulo, and the biggest W&S provider in Brazil – Companhia de Saneamento Básico do Estado de Sao Paulo (“SABESP”) - in order to assess what problems, if any, the regulatory agency might face while monitoring and regulating these concession contracts.

Conclusions were that, at least for the three contracts analyzed, the regulatory agency will face very few hurdles to perform its regulatory and monitoring obligations adequately, assuring the efficient execution of those services, and promoting public interest in general.

2 BRIEF METHODOLOGICAL CONSIDERATIONS
Initially, there is the need to explain how and why the Municipalities of Bora, Sao José dos Campos and Sao Paulo serve as noteworthy case studies. SABESP operates in 366 municipalities of the State of Sao Paulo and is now obliged to enter into formal concession contracts with all of them. These cities have significantly different profiles, not only with respect to size and complexity (for example, some have shanty towns, others do not), but also to the development levels of their W&S services. These three cities were then chosen because they could represent this diversity well.

The city of Borá was chosen because it is the smallest Brazilian city. Therefore, it is the perfect city to represent the category of municipalities that, given their lack of economic importance, do not have any bargaining power to negotiate a contract with the company. Thus, the city theoretically would have to accept any contractual terms the company presents to it, or the services would not be provided (at least by SABESP). Furthermore, this contract is particularly interesting because it was executed on September 6th, 2007, prior to the existence of the regulatory agency (created on December 8th of the same year by Complementary Law 1025/07).

The city of Sao José dos Campos (“SJC”) was chosen because it represents a contract executed with a medium-sized city of the State (according to the 2010 census, SJC has approximately 640,000 inhabitants), a class of cities with considerable bargaining powers. Additionally, the first concession contract executed between SABESP and the city of SJC, dating back to 1976, was also available, creating the possibility of a comparison between contracts (the newer one was executed in December 2008) to see which changes took place.
Finally, the contract executed with the city of Sao Paulo (“SP”) was a mandatory analysis as the gross revenue obtained by SABESP in the city represents 55.5% of the company’s entire revenue. Such large figures allow Sao Paulo, as a city with bargaining powers sufficient to negotiate very favorable terms for itself, to represent, at least in theory, the counterpoint to the case of Borá. Moreover, the contract is also very recent, as it was executed on June 23rd, 2010, making it interesting to analyze if there is any new trend that can be identified.

Explained that, we must briefly focus our attention to the history of W&S services in Brazil to understand the sector’s implementation and where it stands now.


Basic Sanitation in Brazil has a rather unusual record. As previously explained, the provision of W&S services falls under municipal jurisdiction, although such jurisdiction is dubious in metropolitan areas. States and the Federal Government must define complementary macro-level politics for the sector, as well as to collaborate for its development.

Historically, the sector’s development model dates back to 1967 with the creation of PLANASA, the National Sanitation Plan, which redistributed resources from a public bank, the National Housing Bank (Banco Nacional de Habitação, “BNH”), towards investments in sanitation. To gain access to these resources, states had to create both financing funds in Water and Sewage and a state-owned company that would celebrate concession contracts with the municipalities. These contracts were extremely vague\textsuperscript{11} and can be taken almost as non-existent. In many cases they actually did not exist and the company operated on the basis of verbal agreements or other forms of authorization\textsuperscript{12}. Under this regulatory framework, what really happened was that each company was self-regulated, defining its own investment policy, plans for universal coverage and rates charged for the provision of the services as it deemed appropriate and without formal external control.

In the state of Sao Paulo, the company created to provide such services was SABESP, the Brazilian powerhouse considered to be the biggest water and sewage provider in Latin America. SABESP’s stocks are listed both on the Brazilian and the American stock exchanges.
and, with an annual gross revenue of R$ 8,579.5 million in 2009, the company is responsible for operating W&S services in 366 of the 645 municipalities of the state of Sao Paulo, with coverage rates of 99% for water supply, 80% for sewage collection and 74% for sewage treatment.

After its creation, the company operated under PLANASA national directives, in a model that was not considered to be very efficient. This reality changed with the collapse of the Public Sector finances in Brazil (both Federal, State and Municipal governments), during the middle/end of the 70’s. This near bankruptcy put the old model, heavily dependent on Federal money, in crisis, leaving the sector of basic sanitation completely abandoned by the Brazilian Government.

Changes only began to occur in 1998 after the constitutional amendment 19/98, which modified article 241 of CF/88, and in 2005 with the enactment of law 11.107/05, which allowed for the associated management of services, the formation of public consortia and the execution of cooperation agreements between public entities, changes that permitted public entities to formalize understandings to jointly provide public services. This paradigm shift in the sector was further developed in 2007 with the enactment of federal law 11.445/07, or the “Water and Sewage Law”, which created a completely new legal framework for the provision of water supply and basic sanitation services. More recently, the Federal government enacted decree 7.217/10 to regulate the pending items of law 11.445/07. All these modifications in the W&S sector were made under the correct rationality that the W&S sector requires capital intensive projects with long maturation periods (around 62 years), which makes it impossible to provide universal coverage with only public actions and resources.

The overall goal of those changes, therefore, was to create a safe legal environment capable of attracting private capital to invest in this area, which indeed started to happen with higher intensity in the last few years.

Further analysis reveals that, based on the provisions of article 241 of the CF/88 and on article 13 of the law 11.107/05, which created the so called Program Contracts, the W&S law rationality was to delimit a new legal framework for the area of basic sanitation, bringing it closer to the one existing in other sectors. Many points of this new regulation deserve special attention.

Firstly, the formal relationship between the grantor and the grantee was completely modified. Old concession contracts, whose
provisions barely covered the delegation of the services by the municipalities to the providers, were replaced by very specific and detailed ones.

According to article 10 of the new law, all concessions granting the exploration of W&S services should be established through a specific contract, celebrated only for this purpose\textsuperscript{17}. To avoid completely generic concession contracts that provided great freedom to the concessionary, other articles state that these contracts should also have clauses that determine, among other things, the existence and maintenance of an economic and financial equilibrium between the revenues and expenditures predicted for that specific concession; the concession period; specific and gradual targets and deadlines regarding coverage ratios to be achieved by the concessionary and technical tariff readjustments\textsuperscript{18}. To assure that the law would be followed, and in order to accelerate its implementation (aiming for the compliance of all concession or program contracts with the more stringent standards of the new legislation), the law also sought to attack precarious concessions, stating in its article 58 that all precarious concessions would be terminated by December 31\textsuperscript{st}, 2010.

In conjunction with the execution of contracts came the need to establish a basic W&S regulatory authority in charge of both monitoring and regulating all signed contracts. This regulatory body should be necessarily independent (administrative and budgetary) and should have as primary objectives to achieve the universalization of the provision of the service and enhance both its quality and the affordability of the rates charged\textsuperscript{19}. To facilitate the fulfillment of such obligations, the grantor was given the option of delegating the entire organization, supervision, regulation and the execution of such services to other entities\textsuperscript{20}. The borders of the state in which the municipality is situated were set as both the geographical and political limits to such delegation of authority\textsuperscript{21}.

As a direct response to new federal regulation, the Government of the State of Sao Paulo promulgated in 2007 the Supplementary Law 1.025/07, which expanded the powers of the former Public Service Commission of Energy (Comissão de Serviços Públicos de Energia, CSPE), creating the “Agência Reguladora de Saneamento e Energia do Estado de Sao Paulo” – “ARSESP” - the independent regulatory agency of the state’s W&S sector. The remodeled agency is empowered to “regulate, control and supervise, within the State, the services of piped gas and W&S services whose provider is the State, preserving the municipal powers and prerogatives”\textsuperscript{22}. In order to achieve success in
this mission, the agency must “art. 7. (...) V - set service quality and providers’ performance criteria, indicators, formulas, standards and parameters, ensuring compliance and encouraging the constant improvement of quality, productivity and efficiency of the services as well as the preservation, conservation and restoration of the environment; (...) VII - apply the sanctions provided in the contract or in the relevant legislation, including the Federal Law No 8.987 of February 13, 1995 and the Federal Law 9.074 of July 7, 1995, and, finally, “art. 10. (...) IV - considering the pricing guidelines set by decree, set tariffs and other forms of compensation for the services rendered, as well as proceed to its readjustment and review, aiming to ensure both the economic and financial balance of the provision of the services and affordable rates for final users, through mechanisms that induce increased efficiency in the provision of the services and enable social appropriation of productivity gains”.23.

To ensure its financial and political independence, the agency is financed through a fee charged directly to the service providers it regulates.24 Furthermore, it has a technical board consisting of five members approved by the legislature of the State of Sao Paulo, serving for fixed terms of 5 years, without the possibility of reappointment, and who cannot be withdrawn from their positions without a formal administrative procedure and only in case of willful misconduct.

Concluding, given all the factors abovementioned, the basic sanitation sector of Brazil, and more specifically of the State of Sao Paulo, has undergone a total revolution.

4 Analysis of the W&S reality in the State of Sao Paulo
To comply with the new law and renew all concession contracts, even before the creation of ARSESP (as shown in the contract of the municipality of Borá, executed in 2007) Sao Paulo’s State Government started offering municipalities what can call “large sanitation packages”. Those consisted of: a-) the cooperation agreement signed between the State Government and the City entitled to provide the service, b-) the provision of W&S services by SABESP (with all the universal coverage expansion expenses paid with funds from the company) and c-) ARSESP’s regulation of such contracts. This “package” was interesting for both the municipal and the State governments because it strengthened the position of SABESP as concessionaire (a State company with enough funds to afford the
expansion of these services without a monetary contribution from the municipality) and of ARSESP as a new regulator.

The outcome of these legal changes and the effort by the State to execute new contracts with the municipalities which SABESP operated has been relatively successful. As data from the company shows, from the 366 municipalities it operates, by the middle of 2010 it had already signed 196 new program contracts, while 59 other contracts were under negotiation, 80 were still in effect and 31 had not entered any negotiations whatsoever.

These are complex contracts, and a more meticulous analysis showed how, at least the ones scrutinized for this paper, incorporated many of the changes made by the legislation.

The first aspect worth mentioning is the fact that the contracts had a fairly similar structure, and some clauses were even copies of one another. Borá and SJC have almost the same structure and 90% of the clauses have the same dispositions (same text). For example, they are both organized with the 1st clause as “the Contract’s Object”; the 2nd as “Period”; the 3rd as “How Services Should be Provided”; the 4th as “Tariffs”; the 5th as “Rights and Obligations of the Provider”; the 6th as “Rights and Obligations of the Municipality”; the 7th clause is different because the contract with SJC has one disposition more than Borá does, called “Execution of Constructions” so, the 7th clause of Borá and the 8th of SJC are organized as “Rights and Obligations of Users”; the 8th/9th as “Regulation and Monitoring”; the 9th/10th as “Environmental Protection and Hydro Resources Management”; the 10th/11th as “Administrative Sanctions”; the 11th/12th as “Contract Extinction”; the 12th/13th as “Reversibles”; the 13th clause of Borá’s contract is different because it sets indemnification criteria. Then we have the 14th/14th as “Mediation”; the 15th/15th as “Arbitration”; the 16th/16th as “Intervention”; the 17th/17th as “The State Regulatory Agency”; the 18th/18th as “Publication”; the 19th/19th as “Jurisdiction” and the 20th/20th as “Final Dispositions”.

Going deeper into the analysis, if Borá’s contract, theoretically the most company friendly of the three here analyzed, is taken as the basis for the analysis of its specific clauses, we will find that its main provisions include: that the service will be provided on an exclusivity basis and for a concession period of thirty years, renewable for another term; that the service should be provided adequately, continuously, efficiently and under affordable rates; that the service will be remunerated through tariffs, with customers being divided into different tranches, allowing the company to charge different prices to large customers, with readjustments of tariffs every 12
months and periodic tariff revision every 4 years\textsuperscript{31}; SABESP’s rights and obligations, which comprise the need to meet the objectives agreed upon in the contract, the need to send to the municipality within 180 days after the end of the fiscal year a report of all the activities and investments that took place during the past year, the exemption from all municipal taxes and the right to assure the economic and financial balance of the contract\textsuperscript{32}; basic rights of the Municipality (opposite to SABESP’s) and of users of the services\textsuperscript{33}; that the regulation, monitoring and auditing of the contract would be conducted by ARSESP and, secondarily, by the municipality acting as subsidiary monitor\textsuperscript{34}; the administrative penalties, which include warnings, fines (which double in value in case of recurrence, but limited to 0.1\% of the net revenue earned by SABESP in the city during the year prior to the fine), and, last case scenario, an intervention in the provision of the service for a period of up to one hundred and eighty days (the municipality or the state become entitled to deliver the service with all SABESP’s assets, staff, etc.)\textsuperscript{35}; how reversibles should be calculated to determine the cost of providing the services\textsuperscript{36}; and, finally, circumstances causing the contract’s early termination, setting the indemnification owed to each party (the clause holds that this indemnification should be calculated according to a technical economic valuation report, whose conclusion can either reward the concessionaire for the investments realized expecting future profits, or the grantor for any damage caused by the concessionary during the performance of the service).\textsuperscript{37}

Moreover, the contracts still have clear and defined performance goals. As seen in the annexes and technical studies, SABESP must achieve the following goals in each municipality or it can be subject to a batch of different penalties:

Table 1. Quality and performance goals for the city of Borá/SP\textsuperscript{38}
Table 2. Quality and performance goals for the city of Sao José dos Campos/SP

<table>
<thead>
<tr>
<th>YEAR</th>
<th>WATER PROVISION</th>
<th>SEWAGE COLLECTION</th>
<th>SEWAGE TREAT</th>
<th>WATER LOSSES</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>&gt;94%</td>
<td>&gt;86%</td>
<td>&gt;46%</td>
<td>&lt;400</td>
</tr>
<tr>
<td>2008 - 2010</td>
<td>&gt;97%</td>
<td>&gt;90%</td>
<td>&gt;80%</td>
<td>&lt;360</td>
</tr>
<tr>
<td>2011 - 2015</td>
<td>&gt;99%</td>
<td>&gt;98%</td>
<td>&gt;99%</td>
<td>&lt;285</td>
</tr>
<tr>
<td>2016 - 2020</td>
<td>&gt;99%</td>
<td>&gt;99%</td>
<td>&gt;99%</td>
<td>&lt;220</td>
</tr>
<tr>
<td>2021 - 2025</td>
<td>&gt;99%</td>
<td>&gt;99%</td>
<td>&gt;99%</td>
<td>&lt;210</td>
</tr>
<tr>
<td>2026 - 2030</td>
<td>&gt;99%</td>
<td>&gt;99%</td>
<td>&gt;99%</td>
<td>&lt;210</td>
</tr>
<tr>
<td>2031 - 2038</td>
<td>&gt;99%</td>
<td>&gt;99%</td>
<td>&gt;99%</td>
<td>&lt;210</td>
</tr>
</tbody>
</table>

Table 3. Quality and performance goals for the city of Sao Paulo/SP

<table>
<thead>
<tr>
<th>YEAR</th>
<th>WATER PROVISION</th>
<th>SEWAGE COLLECTION</th>
<th>SEWAGE TREAT</th>
<th>WATER LOSSES</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>&gt;96,3%/93,4%</td>
<td>&gt;90,0%/82,4%</td>
<td>&gt;75%</td>
<td>469,469</td>
</tr>
<tr>
<td>2010 - 2012</td>
<td>&gt;98,7%/96,5%</td>
<td>&gt;96,7%/91,6%</td>
<td>&gt;93%</td>
<td></td>
</tr>
<tr>
<td>2013 - 2018</td>
<td>&gt;98,7%/96,5%</td>
<td>&gt;96,7%/91,6%</td>
<td>&gt;93%</td>
<td></td>
</tr>
<tr>
<td>2019 - 2024</td>
<td>&gt;100%/98%</td>
<td>&gt;100%/95%</td>
<td>&gt;100%</td>
<td>Up to 2020:</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>250 to 300</td>
</tr>
<tr>
<td>2025 - 2039</td>
<td>&gt;100%/98%</td>
<td>&gt;100%/95%</td>
<td>&gt;100%</td>
<td>2020: 250</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>to 300</td>
</tr>
</tbody>
</table>

Also, when analyzing these contracts, one can easily notice that all three have ARSESP as a regulatory agency, as planned by the “sanitation package” offered by the State of Sao Paulo to the municipalities. Furthermore, as reported by the agency, 215 other cities also delegated their monitoring and regulatory power to ARSESP. Such a high figure strongly reinforces the role and independence of the agency as the most important regulatory entity of W&S services in the State of Sao Paulo, as it has more power, but also has to report to and is supervised by more agents.

In order to allow the agency to perform adequately its activities, these contracts provide a set of different instruments. Initially all contracts have provisions that fully entitle the agency to regulate and monitor the W&S services of each municipality (delegation clauses). Even Borá’s contract, executed before the creation of the agency,
states in its 8th clause, that “The regulation and monitoring of the W&S services delegated by the municipality will be made by the Water & Sewage and Energy Office (...) or another one that replaces it”. Considering tariff adjustments, Bora’s contract’s 4th clause states that “For the effects of tariff readjustment’s of the present contract, it will be applied the index that results from the variation of SABESP’s costs, or, in case of its extinction, any other that come to replace it, duly approved by the W&S&E Office”. Furthermore, clause 17th states that “In the event of the creation of a W&S state agency, all the contractual powers, rights and obligations of the Water & Sewage and Energy Office will be assumed by the new entity”. Besides, clause 5th states that one of SABESP’s obligations under the program contract is to “forward to the W&S&E Office, up to 180 days after the closing of the company’s fiscal year, an annual report of the economical and financial balance of the contract, management, operation and assets, in order for the agency to update, evaluate and monitor the evolution of the contractual object” (the provision of W&S services to the municipality). This report should provide the agency with all the necessary information for it to assess if the investments made by the company the previous year comply with the goals agreed upon under the contract. It should be added also that these are not general vacant goals. As an example, in concert with the general objectives shown above, attachment I and II of Borá’s contract specifically determine all investments that should be made in the city in each year, breaking them down until they reach every specific project. This means that if the company does not abide by the terms contracted, it will be subject to administrative punishments (10th and 16th clauses) that range from simple warnings and fines (limited to 0.1% of the net revenue of the company in the previous year, as explained), to the declaration of a formal intervention in the provision of the services. As clause 16th of the contract states “Without any limitations regarding other punishments and responsibilities arising from this contract, the State of Sao Paulo, after the municipality’s initiative, but not exclusively, under the terms of article 32 and subsequent of Federal Law 8.987/95, may intervene, exceptionally, and at any time, in the provision of the services object of this contract, with the objective of assuring its adequate provision, as well as the full compliance with agreed upon terms, other regulations and applicable Law”.

A final, but essential aspect that has to be stressed in these contractual agreements for the provision of W&S in the state of Sao Paulo is the role played by the Sao Paulo’s State Government. When we compare all the cooperation agreements celebrated between the municipalities and the State Government, with the direct intervention
of SABESP (as formally stated in the contract’s provisions) and the actual contracts executed between SABESP and the municipalities, we see that they are, as foreseeable, extremely similar. They are, with an exception to Sao Paulo’s contract, almost literal copies of the model contract created by the state in decree 55.565/10. As Both SABESP and ARSESP are state entities, it is highly probably that, even though ARSESP is not a formal part and did not officially intervened in any of these agreements, the state designed such contracts to make them applicable by the regulatory agency.

Whether this is the case or not, in the end, what this analysis shows is that contracts were structured in a way to make it possible for the agency to execute adequately its work. Particularly if considering the clauses that provide that the company must submit yearly reports of performance to the agency and that, if the company does not comply with all the regulatory requirements and the investments it agreed upon, it shall be subject to a range of different and costly penalties enforced by the regulatory agency.

5 Conclusion
As the Brazilian experienced shows, a privatization process might be much less successful when the regulatory agency, the one entitled to regulate and monitor the public services, does not participate in the making of the contract that stipulates the rights and obligations of the service providers. This happens not only because normally these contracts do not have clear goals that must be met by the grantee, but also because whenever the agency needs to adapt the provision to make it more efficient, it normally has to renegotiate the terms of the contracts.

This absence of agency participation in the drafting of the contracts is also seen in the current reforms made into the W&S sector in the State of Sao Paulo, where the State sponsored regulatory agency does not directly participate in the making of the program contract, joining the relationship only in a subsequent period of the concession process (after it was celebrated).

Contrary to what was expected though, the three contracts analyzed had a series of clauses that fully empowered the agency to adequately perform both the regulatory and the monitoring role.

Among many possible factors for this occurrence, a plausible one was that both the service provider, SABESP, the regulatory agency, ARSESP, and the party with whom the municipalities had
to execute a cooperation agreement for service provision, the State of Sao Paulo, are members of the same public entity. This would make it easier for the state to draft a contract where the agency, vital to the efficient provision of the services, would be fully capable of executing its duties.

ATTACHMENT I – Summary of planned investments by SABESP in the city of Borá

Columns: year, water provision, sewage, general use and total (in R$)
ATTACHMENT II – Detailed Investment Plan for the City of Borá

Categories: water provision, sewage, general use and associated with population growth

First column: year; second column: project; third column: value in R$
In 1995 the Constitutional Amendment number 9 ended the legal monopoly of Petrobrás in the oil sector, allowing the government to celebrate concession contracts with private companies to explore the drilling of those resources. The amendment was regulated by law number 9478/97, that not only created the regulatory agency of the sector, Agência Nacional do Petróleo, but also authorized the government to make a partial privatization of the State-Owned company. In 2000 31.7% of Petrobrás ordinary shares were sold in the Brazilian and New York stock exchanges.

This diagnostic is easily confirmed by the fact that almost all big players in this sector are either fully or partially public-owned, like Telebrás, Petrobrás, Furnas, Cesp or Cemig.

Before 1997, the provision of telecommunications was a constitutional Monopoly of the federal government, with the state-owned company, Eletrobrás, being almost the sole provider of such services across the entire country.

Decree 2.592/98, that created the ‘Plano Geral de Meta para a Universalização do Serviço Telefônico Fixo Comutado Prestado no Regime Público’, or the plan that set goals that the providers had to achieve while exploring this public service.

Law 9.074/95, together with law 8987/95.

As disposed on article 4, paragraph 2 of the law, concession contracts could be signed for period up to 35 years. Most contracts were signed for a period of 30 years.

This is a major change implemented by article 58 of the law. Historically, companies have been providing these services based on verbal agreements, deeds of authorization or extremely simple concession contracts. For more information see SABESP 20-F Form 2009.

The article 21 of the Brazilian Constitution (“CF/88”) states that the federal government is competent to “Set guidelines to urban development, including habitation policies, water supplies and basic sanitation and urban transportation”, article 23 states that “The Federal Union, States and Municipalities are equally competent to: (…) promote housing construction programs, and programs aimed at the improvement of habitation conditions and water supplies and basic sanitation.”, finally, article 30 states that “Municipalities are competent to (…) organize and provide, directly or through a concession, permission or authorization, public services that are of local interest, including among these public transportation, considered essential;“. Although not formally expressed, the understanding is that municipalities are the competent power to provide W&S services because they are considered services of local interest, as the W&S are. However there is still a discussion on who is the competent authority to provide and regulate services on metropolitan regions, with a formal ruling from the Brazilian Superior Court (“STF”) still pending. The Court is expected to rule that there must be some kind of joint competency shared between the states and municipalities to provide the service.

According to the 2010 Brazilian Census, the municipality has a total of 805 inhabitants, 10 more than in the census of 2000.

According to the financial-studies made by SABESP, attachments to the
contract, by investing in the city, the company will have a loss of R$1,824,814.21, or in other words, it is only investing in the city because it was ordered by the State of São Paulo, its controlling shareholder, to do so.

11 A good example of how the complexity between the contracts celebrate in the 70’s and the ones being celebrated now is the contrast between the municipal law 1.779/76 of São José dos Campos, which authorizes the execution of the old concession contract, where its 6 pages of clauses where in charge of regulating a concession lasting for 30 years; and the new concession contract, executed in 2008 for the same period, with 536 pages. (the new contract is better analyzed later in this paper).

12 As of December, 2009, SABESP still operated thirty-one cities without any formal agreement.

13 Art. 241. of the Brazilian Constitution states that “The Union, States, Federal District and Municipalities shall discipline by law public consortia and cooperation agreements between federal entities, authorizing the associated management of public services, as well as full or partial transfer of charges, services, staff and essential assets to the continuity of the services transferred”.

14 Today there are three large private controlled companies specialized in providing W&S services in Brazilian municipalities: Foz do Brasil (member of the Odebrecht group, the biggest Brazilian construction contractor), OHL (the Spanish powerhouse) and Cab Ambiental (member of the Galvão Engenharia group, another very big Brazilian construction contractor).

15 “Art. 13. The obligations that a member of the Federation agrees with another member of the Federation or with a public consortium established under joint management and whose object is the provision of public services or full or partial transfer of services, staff or assets required for the continuity of the services transferred, should be established and regulated by a Program Contract, as a condition of its validity.”

16 Program Contracts are contracts signed between a public entity, like a State-Owned Company, and the Municipality competent to provide a public service, granting the first the concession to provide such service. It differs from traditional concession contracts because it can only be executed between different public entities (for example, a State entity and one Municipal one, like in the present case). These two entities must celebrate a cooperation agreement prior to celebrating the program contract. Also program contracts do not need to be preceded by tender bids, as all other concession contracts must.

17 “Article 10. The granting of W&S services to an entity that is not an official administrative branch of the conceding authority depends on the execution of a contract, being forbidden the transfer through unspecific agreements, partnership terms, or other instruments of precarious nature”.

18 “Art 11. The conditions for the validity of contracts which have as their object the provision of W&S services are (...) 2§ In the cases of services provided through concession or program contracts, the rules provided in section III of the caput of this article shall provide for: I - the authorization for the hiring of services, stating the time and area to be served; II - the inclusion, in the contract, of the objectives of progressive and gradual expansion of services, of quality, efficiency and rational use of water, energy and other natural resources in accordance with
the services to be provided; III - priorities for action, consistent with established goals; IV - terms of sustainability and economic-financial balance of the provision of services in an efficient manner, including: a) the billing system and the composition of taxes and tariffs b) the readjustment and revision of taxes and tariffs, c) the subsidy policy; V - social control mechanisms in planning, regulation and supervision of services; VI - the hypothesis of intervention and retaking of services’.

19 “Art. 2 The public W &S services shall be provided based on the following principles: I - universal access; II - integrality, understood as the sum of all activities and components of all W &S services, providing the population with access in accordance to their needs and maximizing the effectiveness of actions and results; III - water supply, sewerage, urban sanitation and solid waste management performed in a manner appropriate to public health and environmental protection; (...) VII - economic efficiency and sustainability; (...) XI - safety, quality and regularity. (…)

Art. 21. The exercise of the regulatory function will meet the following principles: I – Independent decision-making, including administrative, budgetary and financial autonomy of the regulatory authority; II - transparency, expertise, objectivity and celerity of decisions.

20 “Art. 8 Holders of public sanitation may delegate the organization, regulation, supervision and provision of these services.”

21 “Art. 23. The regulatory authority shall issue rules regarding the technical, economic and social dimensions of the services, which cover at least the following aspects: (...) 1 - The regulation of public W &S services may be delegated by the competent authority to any regulatory entity formed within the limits of the State, making explicit, in the act of the delegation of the regulation, the form of acting and the scope of activities to be performed by the parties involved. “

22 Article 6 of Sao Paulo’s Complementary State Law 1.025/07.

23 Sao Paulo’s Complementary State Law 1.025/07.

24 “Art. 29 - The regulation, control and supervision rate is generated by the performance of the regulation activity, the control and supervision of AR SESP, and will be taxable: (...) II - the providers of state-owned public sewerage, by virtue of concession, permission, authorization or legal delegation;”

25 Internal rules of AR SESP “Art. 9 - The Board of AR SESP will consist of five (5) Directors, distributed as follows:
1 - Directorate of Technical Regulation and Supervision of energy services; II - Directorate of Technical Regulation and Supervision of the services of piped gas distribution; III-Directorate of Technical Regulation and Supervision of basic sanitation services; IV - Directorate of and Economic and Financial Regulation and of Markets; V - Director of Institutional Relations. § 1 - The Directors shall be appointed after public hearing and approval by the Legislative Assembly. § 2 - The Officers shall exercise non-overlapping mandates of 5 (five) years, with no possibility for reappointment. “

26 In this win-win situation acceptance was so widespread that in 2010 the State Decree 55.565/10 was enacted. This decree had, as Appendix I, the official program contract’s minute adopted by the State, creating a standard contract that should work as a reference to future agreements.

27 Pages 13, 14, 15 and 16 of the 20-F Form referent to the year 2009.
The contract signed by the company with the city of Sao Paulo stands out clearly in clause 35 by providing that SABESP is obliged to allocate to a Fund for Municipal Sanitation 7.5% of the gross income obtained in the city, and that 13% of the gross income obtained in the city has to be reinvested in projects also made inside the municipality; also, the 5th clause submits the planning of actions and investments executed under the contract to a managing committee formed by three members of the city council and three members of the State. Other than that, most dispositions are basically the same, although more specific. For example, contracts normally say that the regulatory agency will have the power to set tariffs according to a formula of its own making (Clause number 4 of the contracts). Sao Paulo’s contract states this as well, but in clause 35 it specifically expresses that the agency is entitled to discount from future tariff readjustments the price it reasonably believes to be above the ones contracted under normal market conditions.

This is disposed in the first and second clauses of Bora’s contract. To confirm that it can be used as a basis for comparison, the two other contracts also have similar dispositions, for example, the same provision is made in the first and second clauses of SJC’s contract and in the first and 67th clauses of Sao Paulo’s contract. As all these contracts have considerable volume (Sao Paulo’s contract digital archive has 461 MB of data), they will not be attached, although they can be found with the author.

Contract’s third clause, with equivalents on the third clause of the SJC’s contract and the 15th clause of Sao Paulo’s contract.

Bora’s contract fourth clause, with equivalents on the fourth clause of SJC’s contract and 41st and 52nd clauses of Sao Paulo’s contract.

Bora’s contract 5th clause, with equivalents on the 5th clause of SJC’s contract and in the 29th and 30th clauses of Sao Paulo contract.

Bora’s contract sixth and seventh clauses, with equivalents on the sixth and eighth clauses of SJC’s contract and 26th, 27th and 28th clauses of Sao Paulo’s contract.

Bora’s contract eighth clause, with equivalent on the 10th clause of SJC’s contract and 2nd, 15th and 48th clauses of Sao Paulo’s contract.

Bora’s contract 10th and 16th clause, with equivalents on the 11th and 16th clauses of SJC’s contract and in the 60th and 64th clauses of Sao Paulo’s contract.

Bora’s contract’s 12th clause, with equivalents on the 12th clause of SJC’s contract and 19th and 24th clauses of Sao Paulo contract.

Bora’s contract’s 11th and 13th clauses, with equivalents on the 13th clause of SJC’s contract and from the 68th to the 81st clause of Sao Paulo’s contract.

For water provision, sewage collection and sewage treatment, the percentages are expressed as minimum rates that should be achieved by the company in the respective year. For water losses it represents the number of liters lost per one extension per day.

In Sao Paulo’s case, as the contract is normally more specific in its provisions than the other two, the performance goals were divided two parts: coverage and...
utilization. Coverage means the availability of W&S access, and the utilization the actual use of those services (being connected and using the available network). Following this premises, universalization goals were also divided into coverage and utilization. On the tables, the first number refers to coverage, and the second one to utilization.

40 According to the agency’s website: <http://www.arsesp.sp.gov.br/secoes/index.asp?setSecao=saneamento&setPage=municipios> (last visit: 08.06.11)

41 See, for example, municipal laws 490/07 of the city of Borá and 371/08 of the city of SJC, which authorize the municipalities to enter into the cooperation agreements with the state of Sao Paulo. Sao Paulo’s city has just law 14.934/09, which generally authorizes the municipality to execute agreements with other public entities, the cooperation agreement is not publicly available and was sent to the author directly by ARSESP.

42 Page 63 of Bora’s concession contract.

43 Page 84 of Bora’s concession contract.