PPPS AND CONCESSIONS

GUIDE ON LEGAL AND REGULATORY ASPECTS

CBIC

VG&P | VERNALHA GUIMARÃES & PEREIRA ADVOGADOS

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PURSUING THE FUTURE

Times of crisis are open doors to failure or opportunities for building new paths. It depends on one's outlook and willingness. Brazilian businessmen have a natural instinct to roll up their sleeves, face the problems and reinvent themselves, used as they are to the repetition of retraction cycles. At this time, when Brazil navigates one more crisis, civil construction pursues solutions and works to recover its past performance. It is in this background that public-private partnership and grant modalities (PPP) have entered the industry's radar and are now seen as a path to open a new outlook for construction; these are tools that may recover investment capacity, now repressed due to the crisis.

Companies in the civil construction industry are willing to give this step ahead. *The Brazilian Construction Industry Chamber (CBIC)* has been leading a dialogue with the federal government and other players aiming to open new markets and to enhance project modelling, in order to increase competition and transparency to the bidding process. In the other hand, we have been encouraging company qualification, feeding them with information and nurturing a thorough debate on how to enter this market and what contribution give to Brazil at this point. This is a joint effort with Senai and is really important. Civil construction can do a lot for Brazil and it is getting ready to bid for and execute works in several segments being served for grants and PPPs.

In 2016, we will follow through the seminar cycle to discuss this topic and to inform industry's executives. We have travelled around the country to gather experts from several technical areas related to projects of this nature - in these meetings, we discuss contracts, project modelling, legal issues, and cases to improve knowledge and better prepare the entry of the construction industry in this sector. This guide you have in your hands now is one of the tools through which we aim to facilitate the understanding of legal and regulatory aspects for grants and PPPs, a critical step for the success of ventures. This guide benefits from the qualified knowledge brought by the law firm *Vernalha Guimarães & Pereira Advogados (VG&P)*, which has been studying and discussing thoroughly this topic - a very beneficial partnership for CBIC and its associates.

Enjoy!

TABLE OF CONTENT

6. BIDDING

7. RISK MATRIX

8. WARRANTIES

9. PROCEDURE FOR EXPRESSING INTEREST (PROCEDIMENTO DE MANIFESTAÇÃO DE INTERESSE, PMI)

10. SPECIFIC PURPOSE ENTITY (SOCIEDADE DE PROPÓSITO ESPECÍFICO, SPE)

11. CONFLICT RESOLUTION

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1. A PRIMER ON THE CONCESSION OF PUBLIC SERVICES

{1.1 WHAT ARE PUBLIC SERVICE OR WORK GRANTS, AND HOW DO THEY WORK?

Common grants of public service are contracts signed between private companies and the Public Administration, whose object is to deliver public services directly to users. In a common grant, the grantee corporation is in charge of providing all infrastructure required to provide the public service, being compensated through the fees paid by those using such services. For this reason, this is considered as a self-sustainable contract in financial terms, as it does not rely on subsidies from the Public Administration.

The grantee's compensation sources are revenues from fees and (eventually) ancillary or alternative revenues derived from ancillary business lines that may be related to the grant but are not involved in the delivery of the public service itself (for instance, exploring advertising spaces and malls along a granted highway).

A common public service grant may involve (and as a rule, it does) the execution of a public work. In many cases, making the public service available depends not only on carrying the works but on its equipment. The grantee is in charge of providing and funding all required infrastructure to deliver the public service to users. For this reason, it is a custom to say that the object of grants is a complex one, as it may encompass multiple deliveries (as opposed to what happens with common contracts, such as the public work contract, whose object is unique and specific).

A derivation of a public service grant is the public work grant, which is considered as a contract signed between a private company and Public Administration, whose object is the execution and exploration of a public work (for instance, building and exploring a bridge). Just like the public service grant, the grantee of a public work grant will be compensated by fees paid by users for the use of the work and eventually by ancillary or alternative revenues, as aforementioned. The distinction between the common grant of public services and a public work grant is not relevant as both receive virtually the same legal approach.

For this reason, it will be used from now onwards the term "common grant of public service" (or simply, "common grant") to refer to both common grant of public service and public work grants.

COMMON GRANTS OF PUBLIC SERVICE ARE CONTRACTS SIGNED BETWEEN PRIVATE COMPANIES AND THE PUBLIC ADMINISTRATION, WHOSE OBJECT IS TO DELIVER PUBLIC SERVICES DIRECTLY TO USERS

{1.2 HOW COMMON GRANTS DIFFER FROM CONVENTIONAL ENGINEERING WORK AND SERVICE CONTRACTS?

Common grant contracts are different from conventional engineering work and service contracts for many reasons, including.

Distinction of project scope

The first distinction is the breadth of scope. As the objects of public work contracts is limited only and solely to the execution of the work upon the receipt of a project (usually just a basic project) from the Public Administration, the object of a grant is broader and is focused on the delivery of a public service. The grant may involve the execution of a work and the supply of goods, but such deliveries are the means through which the grantee is able to deliver the public service to the user.

Herein lies a difference in relation to the scope and complexity of the sequence of contracts and deals that are carried out for executing a grant, when compared against conventional work contracts. A grant may involve contracts with engineering work and service providers (such as contracts called *EPC - (Engineering Procurement Construction)*, contracts for providing goods and technology, and contracts for outsourcing (service delivery) of installments of operation of the public service. The grantee will work as a grant operator, being in charge of articulate, integrate and manage all these business as a means to ensure the public service delivery to the user. In common work contracts, the chain of contracts as a means is smaller, and the Hired Party focuses on the execution of the work itself.

Distinction of the identity of the service grantee identity and the compensation structure

The second distinction is the identity of the service grantee. A work contract is executed by the Hired Party on the exclusive interest of the Public Administration, as the work was hired, received and paid for the Public Administration. In the other hand, the common grant assumes the delivery of a service directly to users and not to the Public Administration. In the grant, the Public Administration is not a grantee, direct beneficiary or payer for services delivered.

These will be directly executed to be used and paid for users, and there is a service delivery relation among them and the grantee every time the service is used. The Public Administration, as the Grantor of the grant, is in charge of planning, delegating, oversighting and controlling its execution.

The Grantee, thus, is subjected to the control and oversight by the Public Administration, although it delivers the service to the user. Such control can be performed directly by the Public Service Administration or by entities of its Indirect Administration (regulation offices, for instance).

This implies in differences in the compensation structure. As said before, the Grantee compensation comes from fees collected (and eventually from alternative revenues) and not from Administration payments, as it is with conventional contracts. In many cases, this causes the transfer of the risk of demand to the Grantee (risk of exploring the business) once the Grantee's compensation will be impacted by the public service level of use (although this can be mitigated by adopting positive and negative risk of demand sharing, depending on the grant contract. This is a formula that has been frequently used especially in greenfield projects, as we will see later.) Furthermore, the fee is a price regulated and controlled by the Administration and (depending on the type of public service) can undergo more or less intervention, ensuring to the Grantee, in any case, the adjustment of the economic-financial equation. In the other hand, the compensation structure of a work contract is simpler as payments are usually linked to the financial-physical schedule delivery benchmarks.

Distinction of the autonomy level of management

The third distinction is related to the management and execution autonomy level. In common contracts, such as the public work contract, the Hired Party has a small room for management as its fundamental scope will be to strictly execute the project being hired and made available for the Public Administration. As this project tends to be quite detailed (specification level compatible with the legal definition of a *basic project*), there is not much freedom or autonomy by the Hired Party to manage the selection of raw materials and means that will be employed and used in the work execution. It is used to say that these contracts work from a control that is focused on means and not on outcomes.

Alternatively, grants do not assume that the projects will be exhaustively detailed or specific. The studies that follow granting programs are more high level and focus on reaching outputs and not on specifying the means. This gives more freedom and autonomy to the Grantee on managing the grant as opposed to common work contracts. On a grant, the management of the means is performed by the Grantee, who will strive to reach the expected outcomes for the public service and grant performances. Even when the grant object includes the work execution, legislation does not require delivery of a full basic project, and a pre-project suffices. The goal is to transfer to the Grantee all the risks of the project that are inherent to the selection and management of means for achieving the outcomes.

Distinction of incentive structures (efficiency) and long-term responsibility

Another difference that can be spotted is the fact that the Grantee takes a long-term responsibility over the works and goods that are the object of the grant, which does not happen in a conventional hiring. Remember that a grant is a long-term contract usually encompassing the execution and acquisition of works and goods that are used for the delivery of the public service and then transferred to the Public Administration assets. This demands a long-term management rationale over the goods that are the object of the grant, which is not the case for contracts only for works, for instance, where the company's responsibility ends in the moment when the work is delivered (and also through the period of legal responsibility over the solidity of the work).

In addition, the integration of diverse scopes in the grant's object allows for assigning the Grantee with the responsibility of designing the project, execute the work and still keep it long-term, which aligns all interests and is able to provide more efficiency to the grant. The Grantee has incentives to design and format an excellent project, as imperfections will end up generating costs during the work execution. Equally, the Grantee will tend to prevent the use of low quality materials or inefficient construction techniques, once issues arising from the work execution will translate into higher maintenance costs. Such risk concentration structure (bundling) with the Grantee's realm is able to generate higher efficiency to the grant contract when compared against conventional hiring, which has stricter, limited scopes.

{1.3 HOW A GRANT'S FINANCIAL-ECONOMIC STRUCTURE IS BUILT?

In order to facilitate learning, it is usually to divide a grant into two large phases: (i) preparatory phase (or phase of works or phase of investments); and (ii) operational phase (or public service delivery phase). The preparatory phase covers the execution of the required infrastructure for delivering the service. It is in this phase that financing is obtained, investments are decided upon and works and goods required for making the public service available to users are made. The operational phase covers the period of delivery of the public service (involving also the administration of all charges required for its maintenance).

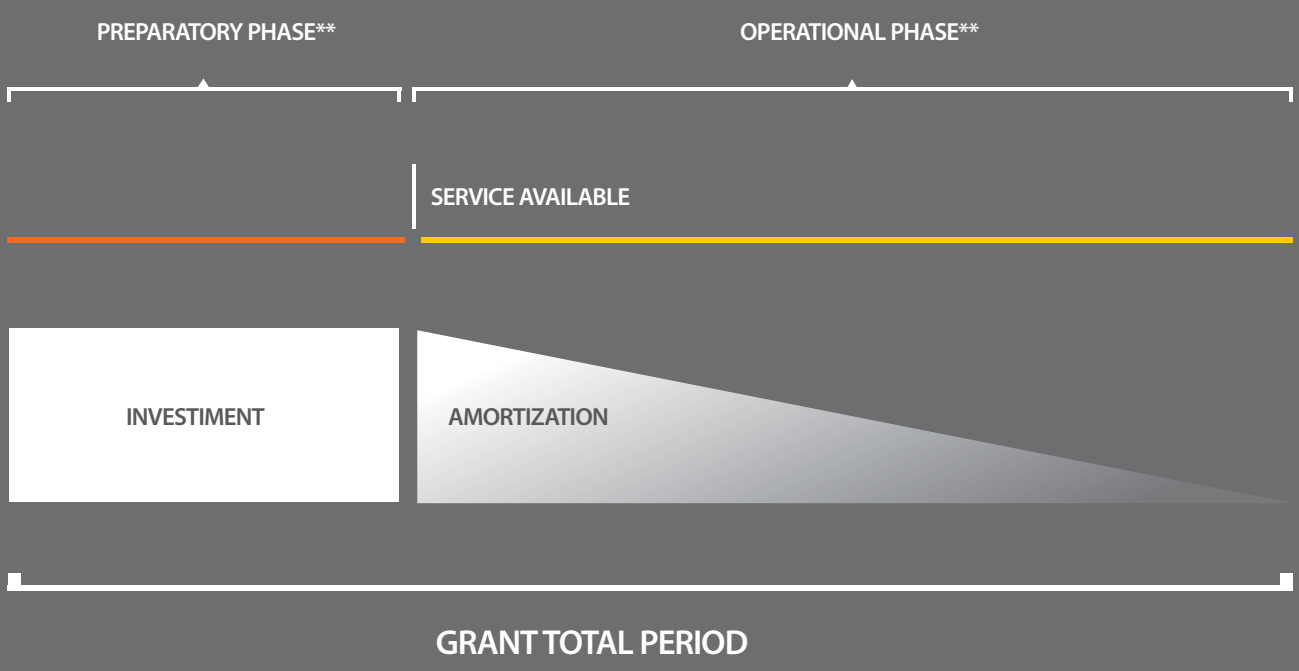
As the grant revenues are tied to the payment of fees by using the service, which only takes place in the operational phase, all the infrastructure execution phase will depend on investments from the Grantee to provide works and other goods. All investment made in the initial step will be amortized through the operational phase by receiving the fees. Thus, the grant period has a critical relevant for its economic-financial equation, as it must be suited to allow for amortization and depreciation of all assets invested in the grant, in addition to ensure a reasonable return rate to the Grantee.

It is for this reason that the legal regime for the common grant period differs from that of the conventional hiring. Whereas Law 8.666/93 determines a maximum period of 60 months for common service delivery contracts (article 57), there is no such limitation for grants (exception made to some types of grants in which special laws determine maximum terms), as usually periods are long and adjusted according to the grant's economic-financial structure.

It is precisely due to the lack of income in the initial step of the grant that there is a large concentration of financial risks in this step. Financing is usually more expensive during the preparatory phase, which causes refinancing and the exemption of warranties from the beginning of the operational phase. Financing agents see risks in the initial step with relation to the Grantee's performance on executing the works and finalizing the infrastructure, which casts doubts on the project's potential for generating revenues. For this reason, financing costs tend to be higher during the preparatory phase.

On this perspective, grant projects with a financial profile that prevents a large concentration of investments in the preparatory phase may allow not only for a smaller financial cost for the project as to widen the access of smaller companies to the grant's business.

FIGURE 1 – COMMON GRANT STRUCTURE



Period without revenue but with investments.

Period with fee revenue.

* Preparatory phase: Investment in works and equipment aiming to create and equip the require infrastructure for the service delivery.

** Operational phase: Period of service delivery, across which investments will be amortized.

{1.4 HOW DOES THE FEE SYSTEM OF A GRANT WORK?

The structure of all and any grant depends previously of identifying a fee referential value. Estimating demand and determining the value of the fee (as well as establishing conditions for adjusting it) are basic, critical information for projecting the grant revenue. Legislation admits differentiated fees (by user classes and segments, for instance) and the so-called *social fees* (fee exemption for socializing the public service, for instance special fees for seniors or for the poor), and extra-tax fees (change of the fee value to meet regulation goals, for instance higher fees for consuming electric power in peak hours).

Thus, the fee structure may become complex in many cases when involving different fee levels. The relevant point is that the fee must be affordable, which means that the fee shall not deter the access by the user to the public service. When defining the value of the fee, one must also take into the account the need for covering the grant's production costs and the costs of generating a reasonable return rate to the Grantee. For this reason, whenever the fee revenue ideally considered (complying with the low-value parameters) is not enough to allow for a common grant structure, one shall consider the inclusion of public subsidies (which may lead the grant into a sponsored grant).

It is critical that the fundamental documents of the grant provide the full understanding of all values and operation conditions of the fee structure, allowing for the stakeholders to formulate their commercial proposals (in some cases, the value of the fee will be offered in the bid). This means that all and any change to the value of the fee or in the conditions for its collection that are implemented after signing the grant contract (submission of proposals for the bid) will cause the adjustment of the economic-financial equation.

As a rule, readjusting the value of the fee will take place automatically, free from homologation by the Public Administration. Although there is no legislation allowing for this, PPP legislation determines that contract provisions on automatic update of fees based in mathematical indexes and formulae will be applied without homologation by the Public Administration, except when the Public Administration submit critical reasons for reject such update.

This rule seems perfectly applicable to common grants due to the similarity of adjustments. Furthermore, to eliminate the need for previous homologation by the Grantor to the fee adjustment is desirable as it helps to reduce transaction costs in the hiring of the grant.

2. A PRIMER ON PUBLIC-PRIVATE PARTNERSHIPS

{2.1 WHAT ARE THE SO-CALLED PPPS?

Public-Private Partnerships (PPPs) are long-term contracts formalized between private companies and the Public Administration, whose object might involve the delivery of public services or services to the Public Administration and, additionally, the execution of works and the supply of goods. These contracts are similar to common grant contracts, but they differ both by the integration of financial commitments taken by the Public Administration and by the breadth of their objects, as explained later.

There are two types of PPP in Brazil: (i) sponsored grant and (ii) administrative grant, also called sponsored PPP or administrative PPP. It is possible to realize from the terminology that PPP contracts are siblings to common grants. Just like grants, PPP are complex, long-term contracts involving a peculiar economic-financial engineering and a world apart from conventional contracts. To better understand the aspects and operation of PPPs, it is required to deepen the analysis on both types: sponsored grant and administrative grant.

{2.2 WHAT IS SPONSORED GRANT OR PPP, AND HOW DO THEY WORK?

A sponsored grant or PPP is a type of contract similar to a common contract for public services, with the difference that counter-payments in cash regularly made by the Public Administration are added to the revenue from fees. They are equal to common grant contracts subsidized by the Public Administration. The rise of sponsored grants aimed to allow for grant projects that would never turn in a profit, as revenue from fees are not enough to ensure to cover the contract costs and to provide a return rate to the Grantee, could see the light of day and become profitable by adding public subsidies. By adding public subsidies in the form of regular counter-payments, grants that otherwise would

never make a profit become economically feasible as a sponsored grant.

For this reason, when configuring a given grant project, if it is necessary to add public subsidies, the adjustment shall be modelled as a sponsored grant, in compliance with the PPP legislation. This caveat is relevant because historically (and before the passing of the General Grant Act) it was admitted that public subsidies were added to the compensation in a common grant. Due to the PPP General Act, such modelling was included within the legal regime for sponsored grants, which contains rules aiming specifically to control such financial disbursements by the Public Administration. Exceptionally, there are some who admit the existence of common grants integrated as well by public subsidies (which may assume several legal forms such as subvention for investment, for instance). But the rule is to apply adjustments that require public subsidies as sponsored grant, with the application of PPP legal regime.

It is worth noting that for obtaining a sponsored grant, it is required to have regular counter-payments in cash added to the private partner's compensation. In other words: integrating the public counter-payment is not enough (which is a genre). It is necessary that such counter-payment has the nature of a cash counter-payment (payment in cash or credit granting, for instance). An adjustment assuming public counter-payment of other nature (such as a public asset not in use that is transferred to the Grantee) added to the fee revenue shall be rather modelled as a common grant or an administrative grant, depending on the peculiarity of such adjustment.

{2.3 WHAT IS ADMINISTRATIVE GRANT OR PPP, AND HOW DO THEY WORK?

Administrative grants or PPPs are different from common grants and even from sponsored grants as they do not involve activities for a fee. As there is no fee revenue, the whole Grantee compensation comes from public counter-payments (and eventually from alternative revenues derived from ancillary businesses). Such contracts may have as object, in addition to the execution of works and the supply of goods, services that may be delivered directly to the Public Administration (where the service user is the Public Administration itself) and those delivered directly to the user - however, in this case the Grantee will be compensated by the Public Administration.

The administrative grant, thus, involves services (and other deliveries) that do not allow for charging a fee. These are activities that, due to its nature or by the legal regime applicable, are not divisible into fee units. One example is cleaning streets. It is hard to identify a set of criteria for the fee for users to pay individually for cleaning streets, as this is an activity with a collective benefit instead of an individual one. The delivery of healthcare services or prison services are other examples. It is not possible to charge a fee for using public healthcare services due to their legal and constitutional regimes. Equally, prison services are delivered to the Public Administration so that there are no individually identifiable users. It is the same with all activities and services directly used by the Public Administration, such as the delivery of technical services in a data center, the delivery of public lightning services, the delivery of maintenance services for public buildings and so on.

The creation of administrative grants was driven by the goal of extending the logic of grants to objects that would not be feasible under the "granting" model. It is the idea to allow that projects that did not involve the delivery of a public service under a fee (service delivered directly to the user under the payment of a fee) were modelled as per the economic-financial structure of grants. This allowed, for instance, that services (along with works) that were traditionally hired by the Law # 8.666/93 regime could be hired (alternatively) under the form of a PPP - in other words: based on an economic-financial structure that belongs to grants.

In this regard, when properly used, administrative grants for delivery of works and services in general may imply in a model that is able to generate higher efficiency to the Public Administration when compared against common hiring. This is because, as diverse scopes are integrated (project execution + work execution + service delivery and work maintenance, for instance), it is allowed not only for an efficient risk allocation as for diverse benefits derived from such scope integration (for instance: reduction of overhead costs for contract management - see Figure 2).

Let's picture an example in which Public Administration is willing to (i) build a prison and (ii) hire accommodation services for the prison. In order to carry out their plans, the Public Administration may choose from the conventional regime (Law 8.666/93) or the PPP regime (Law 11.079/2004). In case it chooses the conventional regime, it will have to perform two independent, autonomous hiring processes. Firstly, it will have to bid and hire the work execution, by making available a basic project of the prison facility. After the prison is built, it will have to perform another bidding process, aiming to hire the accommodation services for the prison. If it chooses the PPP regime, the Public Administration may conjugate and integrate both scopes (building the facility and the respective accommodation services), carrying out a single bidding and hiring process for both deliveries. In this case, it is worth remember, only a pre-project of the prison facility will be made available, transferring to the Grantee the duty of

executing the basic project, building the prison and delivering the accommodation services.

Integrating all these scopes into the scope of a single contract allows for generating savings to the Public Administration, as mentioned and exemplified above. Other examples could be applied, such as the building and exploration of public hospitals, building schools with the delivery of supporting services, building administrative centers along with supporting services and so on.

{2.4 WHICH SERVICES CAN BE THE OBJECT OF A PPP?

The PPP object shall comprise necessarily the delivery of a service. It also may involve work execution and even the supply of goods. But there is no PPP without a service delivery. This means that PPPs cannot have as single object the execution of a public work or the supply of goods. Such deliveries, when considered individually, shall be hired under the Law # 8.666/93 regime that governs conventional hiring. In the other hand, although it is perfectly possible that a PPP has as object solely the delivery of services, it is common that other deliveries, such as execution of works and the acquisition and implementation of goods are integrated into the PPP scope. The project complexity is the vocation of the PPP model to allow the combination and integration of different types of delivery. This arises from the aspects of the PPP regime, such as the regime of extended periods aiming to allow for the amortization of seed investments. Remember that in order to put the service into operation, the private partner shall build the required infrastructure, carrying out works and integrating goods in the grant. And as the PPP compensation structure works with the payment for the service, all these investments are amortized across the service delivery period. Thus, simplified services that do not require organizational and operational management, usually depending on long periods for amortizing investments, cannot be the object of a PPP. It is not feasible that the model be used just as an option to the conventional regime to obtain longer periods for common service delivery contracts. Services as simple as public building cleaning, for instance, cannot be hired under the PPP model as they shall comply with the Law # 8.666/93 regime (including the period limitation).

FIGURE 2 – COMPARATIVE CHART BETWEEN TRADITIONAL HIRING AND PPP

Contract aspects	Law # 8.666/93	PPP	PPP advantages against traditional hiring
Object complexity (integration of several deliveries)	It does not allow as a rule the integration of several deliveries. The principle of fractioning is preferred.	It is typical of PPP to join and integrate deliveries of different nature.	The possibility of integrating diverse deliveries and scopes allows: 1)Reduction of administrative costs for managing contracts; 2)Reduction of costs with the regular renewing of the bid process; 3) Better conditions for efficient risk allocation by pursuing interest alignment.
Duration of contract period	It does not allow for setting long periods. The common contract regime determines a 60-month maximum period for service delivery contracts.	It allows definition of longer periods (up to 35 years).	The possibility of longer periods allows: 1)Amortization of investments carried out during the building phase; 2) Transfer to the Grantee of the asset maintenance and administration at the long term.
Payment system	The common hiring payment method is based in a system for controlling and measuring the fulfillment of obligations-means (for instance, requirement of a full basic project for unlocking bids for engineering works).	The PPP payment system allows the compensation by performance, based on reaching outcome goals (service indicators).	The payment by performance method improves efficiency of the hiring, generating incentives for the Grantee to pursue more demanding quality quantity standards.
Compensation for the construction and acquisition of assets/asset returnability	In the conventional hiring, compensation for construction and for the supply of goods is based on measurements and receipt of such deliveries. As a rule, there is no asset returns to the Public Administration at the end of contract.	The compensation of the Grantee in the PPP, including for the execution of works and the supply of goods, is based on the service delivery, admitting the return of assets at the end of contract.	The PPP model also is based on a technique of financing public assets on the long term.

{2.5 PPP'S FINANCIAL-ECONOMIC STRUCTURE

Just as it happens with common grants, the execution of a PPP contract can be divided into two main phases, for analysis purposes: (i) preparatory phase (or infrastructure building phase) and (ii) operational phase (or service delivery phase). In the PPP preparation phase, the private partner will obtain financing, will perform investments and will carry out all works and will acquire all goods required to put the service in operation. The operational phase starts only after the service delivery, or at least a portion of it, and it is when the PPP income is realized (Grantee's compensation).

Such breakdown of PPPs in two overarching phases aims to explain an important aspect of its economic-financial structure: the majority of investments required to structure and make the service available are concentrated in the preparatory phase, which are amortized across the period of service delivery, when PPP revenues start to flow in.

As the Grantee compensation is tied to the service delivery, all expenses incurred at the execution of works and the supply of goods before the service is available are incorporated into the service's price. This dilutes the payment for public assets across the service delivery period, causing the PPP to work, from the Public Administration standpoint, as a way to finance long-term assets.

Such segmentation between preparatory phase and operational phase can also be explained by the restriction contained in the PPP legislation for providing public counter-payments before the service is available (except the so-called "public contributions" - see Item 4.5). There are no revenues in the preparatory phase. There is no revenue from fees (in the case of sponsored grants) as these will come from the service delivery, and there is no public counter-payment due to the restriction established by the PPP legislation. The lack of revenues and the concentration of investments increase the risks in the preparatory phase, from the investor/financing agent standpoint. Precisely for this reason, it is a custom that after the service is available, financial costs fall (opening room for refinancing) and the warranties are exempted.

Due to such structure, the PPP operation period (operational phase) works as a critical element for its economic-financial equation. Such period shall be calibrated in order to allow for the return of investments and the generation of a reasonable return rate for the Grantee.

{2.6 WHAT ARE THE MAXIMUM AND MINIMUM TERMS FOR A PPP?

Legislation has determined that the PPP length is 35 years' maximum. Eventual extensions for the PPP contract shall be calculated in this period. Determining a maximum period has some goals. First, a limit is imposed to the assumption of public financial commitments over time, working as a fiscal responsibility rule. Second, it allows for a regular reassessment of the grant business by the market, encouraging competitiveness in the grant renegotiation assumptions.

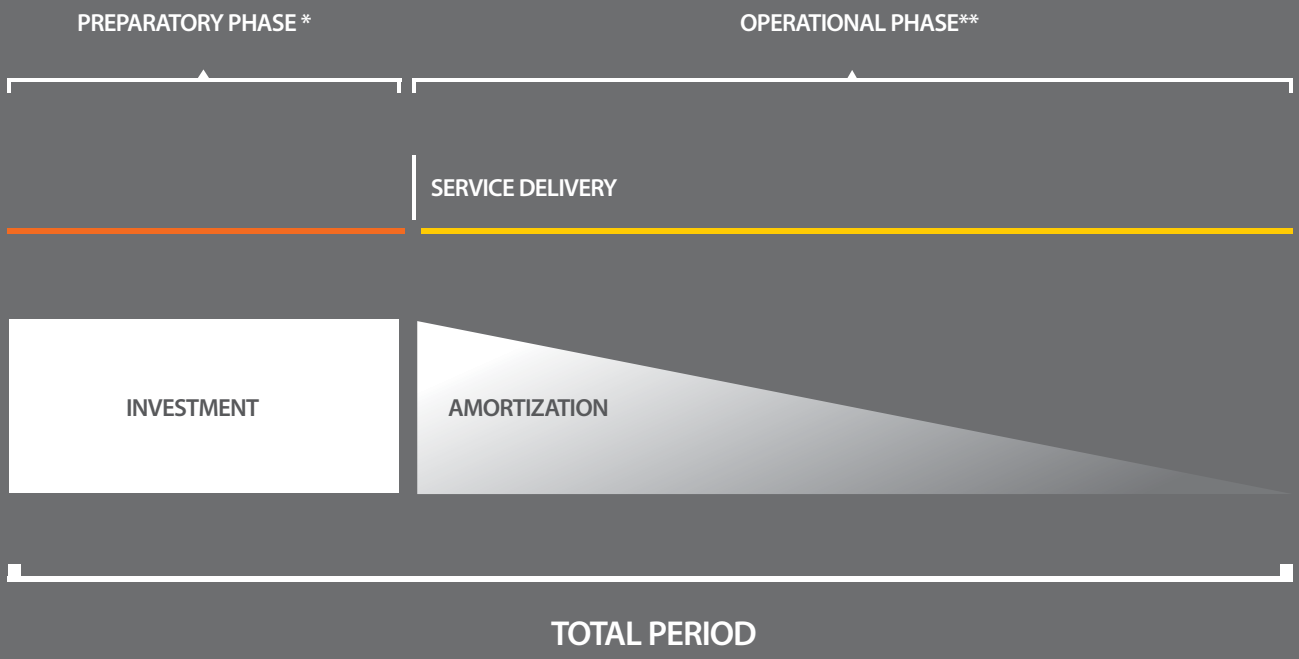
In the other hand, legislation has determined a minimum period for delivering services that are integrated in a PPP. The rationale for imposing a limited period of time for delivering the service is related to the service remuneration structure. The purpose of such limitation is to allow for a minimum period for amortizing investments made during the preparatory phase.

{2.7 WHAT IS THE MINIMUM VALUE FOR A PPP?

According to the legislation, the minimum value for a PPP contract shall be 20 million BRL. This is the benchmark used by the Brazilian legislation. Some states and municipalities have opted to adjust this parameter according to their regional and local realities, albeit a discussion on the linkage of state and city legislations to this parameter (20 million BRL) to the federal legislation is still taking place.

The purpose to institute the obligation of a base value for PPPs is to care for the efficiency in hiring. As preliminary studies for structuring a PPP are always expensive, it makes sense to restrain the unlocking of PPPs with reduced contract value. This is because in these situations, there is a significantly rise of transaction costs. The base value of 20 million BRL is the parameter considered by the lawmaker as the threshold for PPP contracts not being (potentially) inefficient in relation to costs involved in its design and structure.

FIGURE 3 – PPP STRUCTURE



Period with investment concentration and eventual public capital contributions.
Period without public counter-payment.

Period with revenues.

Sponsored Grant: Fee revenue + Cash counter-payment from Public Administration – with the possibility of alternative revenues and public capital contributions.

Administrative Grant: Public counter-payment (without fee revenue) – with the possibility of alternative revenues and public capital contributions.

* Preparatory phase: Investment in works and equipment aiming to create and equip the require infrastructure for the service delivery.

** Operational phase: Period of service delivery, across which investments will be amortized.

3. GRAND AND PPP LEGISLATION

{3.1 PPP LEGISLATION: NATIONAL, REGIONAL AND LOCAL REGULATION

Grants and PPPs are strongly regulated contract models. There are federal, regional and municipal legislation on this topic.

The grant of a public work or service is broadly regulated by Law # 8.987/95 (the so-called General Grant Act), that governs its fundamental aspects, such as rights and obligations of the users of public service granted, charges of the Grantee and Grantor, the fee regime assumptions, requirements related to the grant bid and so on.

In addition to the General Grant Act, Law # 9.074/95 lays out the rules for granting and extending grants and permissions of public services, governing the restructuring of granted services and specifically regulating electric power services. Such acts contain general rules binding not only Federal Administration but also State, Federal District, and City Administrations.

PPPs are regulated by Law # 11.079/2004 (also called General PPP Act) containing general rules that bind all federation entities (Union, States, Federal District and Cities) and also contains federal rules applicable only to the Federal Administration. Law 11.079/2004 established guidelines for hiring PPPs, mandatory contract provisions, has disciplined warranty mechanisms and brought rules for the bid processing. It also covers specific topics related to budget control required for assuming financial commitments on PPP programs. All these central topics related to both common grants (Law # 8.987/95) and PPPs (Law 11.079/2004) were covered by the legislation with binding relationship between Federal, State, and City Administrations.

However, it does not mean that states and cities cannot pass their own specific legislation on grants and PPPs. This is not only possible but desirable that states and cities supplement legislation on PPP and grant models. Such supplementation will take place by passing state or city laws and also by infra-legal acts (regulations and other infra-legal normative acts) that specify the regional or local legal regime for PPP and grant operation and even for the delivery of the public service.

In this regard, it is very common that under regional or local laws, there is the passing of decrees regulating secondary aspects, such as the organic structure of Public Administration for processing PPPs (defining the composition and structure of the managing council and technical committees for processing and analyzing PPP programs) and grants, as well as assumptions and conditions for processing Procedures for Expressing Interest (Procedimentos de Manifestação de Interesse, PMI).

It is worth stressing also that although it is not required (yet recommendable) the passing of regional or local laws for Public Administration to use the PPP model, delegating the public service will depend on Legislative authorization. This means that for delegating a given public service (through a common grant or a sponsored grant, for instance), the Public Administration is required to obtain Legislative authorization under the terms indicated next. Such authorization act for delegating the public service shall be confused with the regional or local law instituting rules on the hiring of a grant or PPP (although such aspects may be governed by the same law), as it has the sole function to authorize the Public Administration to delegate the public service management to the private enterprise. For this reason, it necessarily has to be a regional or local law passed by the Federation entity that is the public service holder. In some cases, legislation may even authorize that Indirect Administration entities (such as autarchies) may get assignments from the Political Person to proceed with the delegation of the public service and appear in the grant and PPP contracts. This is the case, in the Federal sphere, with the National Telecommunication Office (Agência Nacional de Telecomunicações, ANATEL) and the National Electric Power Office (Agência Nacional de Energia Elétrica, ANEEL), as per specific federal legislation (Law 9.247/96 and Law 9.648/98).

The important thing is that the delegation of the public service management is executed by an entity fully capable of such, which will always be the Political Person holding the service or Indirect Administration entities that have received (through a law passed by the public service holding entity) powers and attributions required for such.

In addition to regulation on PPP and common grant operation at the country, state and city levels, Grantee programs shall be modelled also according to the specific legislation on the public service that is being delegated. For common grant and PPP involving the delivery of a public service, the industry legislation will set the conditions for designing such programs. In this regard, that is why grant and PPP programs for basic sanitation services, for instance, shall comply with Law 11.445/2007 (the so-called National Basic Sanitation Act) as well as with city regulation that determine policies for basic sanitation and the Basic Sanitation Municipal Plan (Plano Municipal de Saneamento Básico, PMSB). The same is true for other regulated public services.

4. GRANTEE'S COMPENSATION SYSTEM

{4.1 COMMON GRANT COMPENSATION SYSTEMS

In the common grant for public work or service, the Grantee's compensation will be formed by fees collected and may also involve additionally alternative revenues. A critical aspect of the common grant's compensation system is that it is *self-sustainable*, preventing as a rule the integration of public subsidies. Alternative revenues are those deriving from ancillary businesses, that may eventually be associated to the grant in order to generate supplemental revenue to the Grantee's compensation. An example is the use by the Grantee of the adjacent areas of highways, aiming to develop ventures such as shopping malls. Another example that is typical of grants and PPPs in the sanitation area is the trading of energy in residue treatment plants involving energy reutilization.

It is also possible, although uncommon, that within a common grant, there are public subsidies of other nature that are integrated into the Grantee's compensation system. Although the common grant's vocation is the financial self-sustainability, it has been historically admitted that, in specific cases, there would be the addition of public resources and subsidies to the fee revenue in order to subsidize parts of the grant that are not profitable. Upon the passing of the General PPP Act, adjustments with these characteristics were classified as sponsored grant, a species of PPP. However, it is still exceptionally admitted that, in certain cases and dutifully justified, common grants may add public subsidies to their compensation system, once fiscal responsibility discipline is respected.

{4.2 SPONSORED GRANT COMPENSATION SYSTEM

In the sponsored grant model, the Grantee's compensation comes from fees and the integration of public counter-payments, which have the role of subsidizing the grant. Such counter-payment is of cash nature. Thus, in order to a grant be considered as sponsored, there must be the regular addition of cash counter-payments to the fee revenue. As it was said before, this is a model applicable to projects with potential to generate fee revenue but lacking subsidies to become feasible and profitable.

As it is the case with common grants and administrative grants, sponsored grants also admit alternative revenue derived from the exploration by the Grantee of secondary businesses associated to the grant. In addition to the fee revenue, cash counter-payment, and alternative revenues, sponsored grants may also receive public counter-payments of other nature, such as the transferal of assets and rights. Public counter-payment may take several legal forms, depending on the model. It is only required that there is counter-payment in cash component among other public counter-payment components.

{4.3 ADMINISTRATIVE GRANT COMPENSATION SYSTEM

In administrative grants, the whole Grantee's revenue will come from public counter-payments (not necessarily in cash) and from alternative revenues. There will not be fee revenue integrated to the compensation system. Thus, this model will be used for executing services (and other activities) that prevent the collection of fees (i.e., services that due to its nature are not divisible into charge units).

Precisely for this reason, the object of an administrative grant is closer to the object of a traditional contract for service delivery (governed by Law 8.666/93), despite the models differ in several aspects.

In order to be classified as an administrative grant, there is no requirement for public counter-payments to be in cash. Public counter-payments can take several non-cash forms, such as the granting of rights or assets, and cash forms, such as the granting of credits and payment orders. These may also involve alternative revenues that arise from the development of ancillary businesses in relation to the grant.

IN ADMINISTRATIVE GRANTS, THE WHOLE GRANTEE'S REVENUE WILL COME FROM PUBLIC COUNTER-PAYMENTS (NOT NECESSARILY IN CASH) AND FROM ALTERNATIVE REVENUES.

{4.4 PUBLIC COUNTER-PAYMENT CAN ONLY BE PROVIDED AFTER DELIVERING THE SERVICE

There is a rule in the General PPP Act that prevents public counter-payments to be made to Grantees before the service is available. This means that during the investment phase (or construction and infrastructure building phase), there will not be any public counter-payment. Only when the service can be delivered, after wholly developing the investment phase with construction of works and required equipment, is when public counter-payments start to be made.

There is, however, the likelihood of p*roviding public* contributions destined for construction or acquisition of goods returnable to the Public Administration even before the service is available, i.e., during the investment phase.

From this a difference arises, within PPPs, *between public counter-payment*, which is performed only when the service is available, and public contributions, that can be made to the Grantee before the service is available since the resources are invested in the acquisition or construction of returnable assets.

{4.5 THE POSSIBILITY OF INTEGRATING PUBLIC CAPITAL CONTRIBUTIONS

As it was said before, the General PPP Act recognizes the entity of public contributions. These are public resources paid to the Grantee to be invested only in the acquisition or construction of assets returnable to the Public Administration. Such returnable assets are those that were bought by the Grantee to be integrated into the PPP and then will have their ownership rights transferred to the Public Administration by the end of the contract. As such public contributions are destined solely for building and acquiring these assets, legislation allows public contributions to be made before the service is available (in other words: public contributions can be made during the so-called work phase or investment phase, where the Grantee develops the construction and equips the required infrastructure to make the service operational).

Public contributions were created by the lawmaker as a means to allow Public Administration

to invest resources they already own in the preparatory phase, helping to reduce PPP financing costs. Due to the rule that prevents public counter-payments to be made before the service is available, when the Public Administration has resources that may be invested in an early stage of a PPP would be prevented to do so, thus forfeiting economies that might benefit a PPP by reducing its financing costs - injecting public resources in the preparatory phase would minimize the need for financing by the Grantee, which would end up reducing the PPP overall financial costs. Precisely to work around such financial inefficiency, the lawmaker conceived the public contributions and allowing that such resources are integrated in the preparatory phase of a PPP.

However, allowing for integration and public contributions in the preparatory phase does not mean that public counter-payments can be made in this phase. This is still prohibited. Public contributions differ from public counter-payments exactly because the former is a public resource with the sole purpose of acquiring returnable assets, whereas the latter aims to compensate for the service delivered.

{4.6 THE NEED FOR A PUBLIC CAPITAL CONTRIBUTION SCHEDULE

Investing *public contributions* in the grant shall follow a schedule that is mandatory to be included with the PPP bid's public notice. When executed during the so-called preparatory phase (before the service is available), such contributions shall be proportional to the steps effectively executed. This means that it is not appropriate that contributions are integrated to the private partner's compensation without connection to the fulfillment of benchmarks of the schedule of works and acquisitions in the preparatory phase. The integration of public contributions shall be in sync with the development of the steps determined in the work and acquisition schedule.

INVESTING PUBLIC CONTRIBUTIONS IN THE GRANT SHALL FOLLOW A SCHEDULE THAT IS MANDATORY TO BE INCLUDED WITH THE PPP BID'S PUBLIC NOTICE, IN SYNC WITH THE DEVELOPMENT OF WORKS AND ACQUISITIONS.

{4.7 TAX BENEFITS DERIVED FROM PUBLIC CONTRIBUTIONS

Along with public contributions, legislation has allowed for the application of a different tax regime. This is because the concentration of resources and the expansion of revenues in the beginning of the PPP causes a larger tax burden in relation to taxes that consider revenue or profit in their calculation (such as Contribution for PIS/PASEP, COFINS, CSL, and IRPJ). To prevent such tax inefficiency, the lawmaker admitted the deferral of payment of these taxes from the synchronization of these taxes to the realization of construction or acquisition costs of returnable assets.

Remember that allowing public contributions to be made to private partners before the service is available (only for building or acquiring returnable assets) was intended to prevent financial inefficiencies, as in many cases, Public Administration has resources available to invest in such assets but could not do so due to legislation constraints. Thus, the private partner had to obtain foreign financing for this end, increasing the PPP financial costs.

To allow for investing public contributions during the preparatory phase overcame that inefficiency, reducing PPP's financial costs. In the other hand, concentrating public resources applied to the PPP at the early stages of the contract would end up increasing revenue but also several taxes applying over the Grantee's revenue or profit.

So that, understandably, the change on legislation to allow for public contributions also introduced a different tax regime, admitting the likelihood that taxes such as Contribution for PIS/PASEP, COFINS, CSLL and IRPJ are synchronized with the realization of costs of building and acquiring returnable assets. This will work as a deferral for paying such taxes, which may be diluted over depreciation time of returnable assets.

THE CONCENTRATION OF RESOURCES AND THE EXPANSION OF REVENUES IN THE BEGINNING OF THE PPP CAUSES A LARGER TAX BURDEN IN RELATION TO TAXES THAT CONSIDER REVENUE OR PROFIT IN THEIR CALCULATION. FOR THIS REASON, LEGISLATION ALLOWS FOR DEFERRING TAX PAYMENT.

{4.8 COMPENSATION BY PERFORMANCE

Legislation also admitted the possibility that PPP contracts determine that the Grantee's compensation is tied to their performance. This will mean that the private partner compensation will be impacted by the fulfillment or not of performance indicators previously agreed. PPP contracts will contain, as a rule, service indicators that will reflect several fulfillment levels for outcomes and goals expected for the contract execution. The Grantee's compensation will vary according to the fulfillment of such goals; meeting more demanding goals will trigger the payment of compensation bonuses, and unsatisfactory levels may cause a diminution of the compensation. The goal of linking performance to compensation is to increase efficiency on executing the PPP contract, raising incentives for the Grantee to pursue more demanding levels of quality for the service delivered.

{4.9 SCOPE OBLIGATIONS AND PERFORMANCE OBLIGATIONS

It is customary, for analysis purposes, to differentiate contract obligations whose object is a single, determined scope - for instance: to install in a public building a given equipment for reducing humidity - from contract obligations for performance - for instance: to gauge the humidity level in the internal areas of a public building, aiming to check the Grantee's performance. While the former is an obligation reflecting indicators of means, performance obligations are related to obtaining outcomes. Performance obligations are more relevant in grant and PPP contracts, as the pursue of higher efficiency in executing the contract is tied with the transfer of autonomy to the Grantee to select and manage the means for achieving the expected outcomes. By determining service levels and standards tied to the Grantee's compensation, the contract creates a compensation by performance structure that is able to generate efficiencies to the hiring. The Grantee will tend to pursue more demanding outcomes from the lesser possible cost.

Scope obligations are established in contract for the cases where the Public Administration wishes the execution of a determined scope: fulfilling the obligation is not measured in terms of quantity or

quality, but in binary terms fulfilled-not fulfilled. In a grant or PPP contract, there will be both scope obligations and performance obligations depending on the delivery characteristics - although it is desirable to place emphasis on performance obligations, there are cases in which creating obligations of this nature is not feasible due to practical or technical issues to measure performance.

{4.10 MINIMUM TECHNICAL STANDARD AND PERFORMANCE LEVELS

Even for goals that may be defined in different levels of quality and quantity, there will always be a minimum quantitative or qualitative standard, below which it is configured the Grantee's fault and causing typical contract sanctions (fines and sanctions of other nature). The minimum quality or quantity standard will be established for the cases in which the Public Administration is not satisfied with a less demanding outcome. Alternatively, performance levels reflect outcomes that are satisfactory to the administrative interest, which variation constitutes a scale of benefits to the execution of service.

Compensation by performance is an alternative to repressive systems that are traditionally used to encourage the Hired Party to fulfill their contract obligations (focused on conventional sanctions, such as fines). However, although grant contracts shall emphasize compensation by performance, it will be impossible to avoid its coexistence with a regime of sanctions that is used when expected performance levels are not met. There are cases when not meeting certain qualitative or quantitative level as established implies in an insufficient delivery, which is a non-compliance to an obligation established in contract. We are not talking about meeting service or execution levels of performance obligations here, but contract breaches. Its legal regime is different from the one governing performance obligations.

Whereas performance variation and the fulfillment of performance obligations are characterized only as different methods do execute the delivery in contract (attracting premium sanctions - soft law), not fulfilling a scope obligation or a minimum quality standard is a contract breach attracting the conventional sanction regime (fine and other forms of sanctions).

THE MINIMUM QUALITY OR QUANTITY STANDARD WILL BE ESTABLISHED FOR THE CASES IN WHICH THE PUBLIC ADMINISTRATION IS NOT SATISFIED WITH A LESS DEMANDING OUTCOME.

{4.11 HOW DOES THE MEASUREMENT AND BENCHMARKING SYSTEM WORK FOR SERVICE INDICATORS?

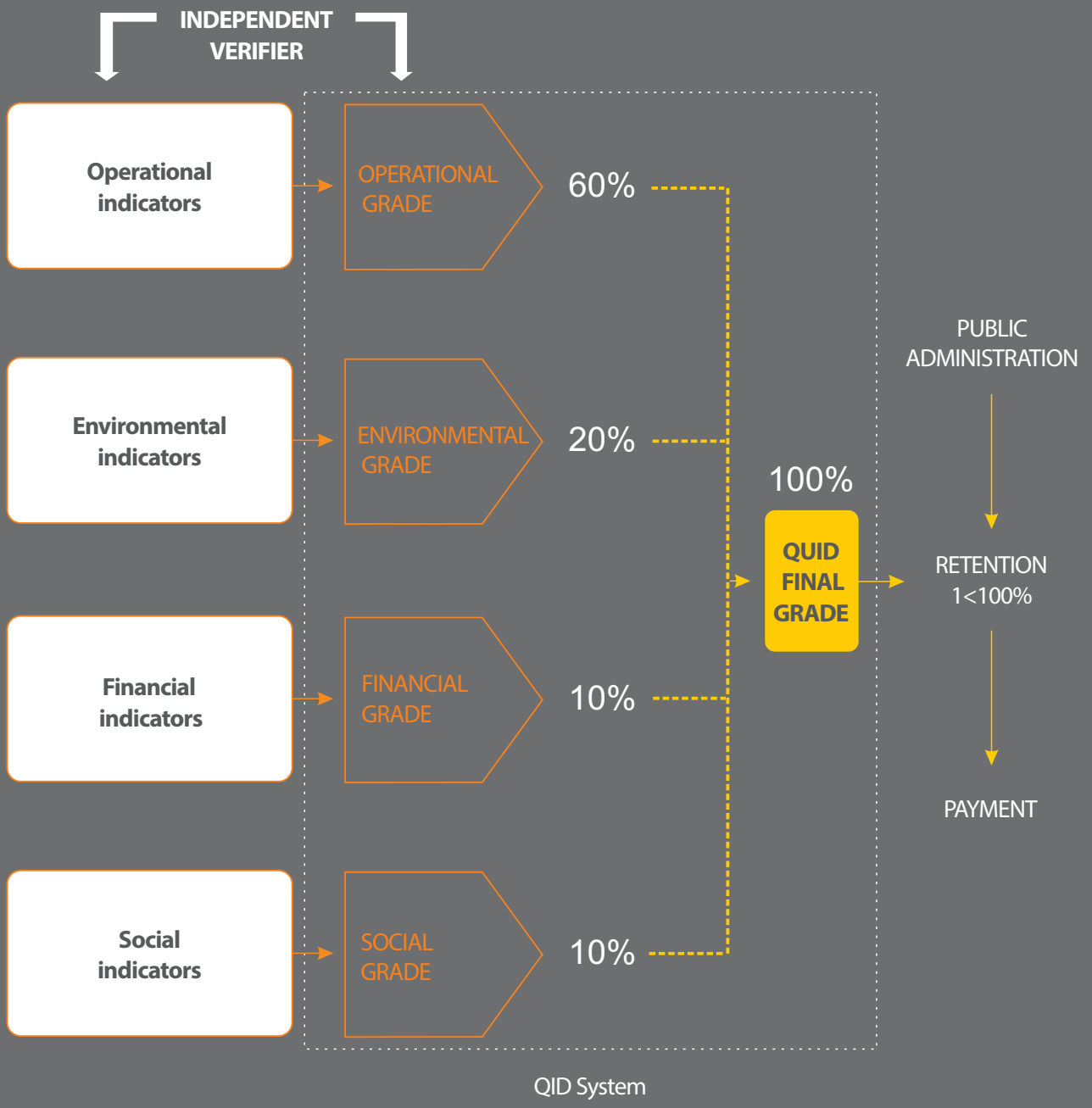
Legislation has not focused more specifically on service indicators and how a variable compensation by performance system would work. It required only that service indicators are connected to functionalities and relevant outcomes for executing the service (and works) that are the object of the PPP contract and that its impact in the compensation system is properly adjusted.

Thus, assessment factors and intervals, as well as the method and the oversight entity, are information that must be included in the PPP contract. Contracts lacking or omitting these matters will help to increase transaction costs.

As for the assessment and measurement system, it is advisable that the PPP contract determines an entity not related to any party. It is not desirable that the Public Administration itself carries such goal and service indicator measurement/assessment out as it is a vested party in the counter-payment due to the Grantee.

The entity carrying the measurement and the assessment out must be unbiased and impartial, helping thus to reduce transaction costs and decreasing PPP's overall cost.

FIGURE 4 – EXAMPLE OF QID



5. PREVIOUS FORMAL AND PROCEDURAL DEMANDS FOR UNLOCKING GRANT OR PPP PROGRAMS

Creating grant and PPP programs assumes the fulfillment of procedures and formalities by the Public Administration during the preliminary planning phase.

In addition to passing regional or local legislation (when the grant or PPP is launched by States or Cities) on specific aspects related to the hiring, and the passing of law authorizing the delegation of a public service (when such law is required), there is a series of formal acts, documents and studies that need to be drafted and made available before launching the hiring process.

{5.1 LEGISLATION AUTHORIZATION REQUIREMENTS FOR DELEGATING PUBLIC SERVICE

Whenever the object of a grant or PPP involves delegating a public service, previous legislation authorizing such delegation is required. Legislation shall be issued to authorize the Public Administration that holds the public service to transfer its management and execution to the private initiative through grants and PPP programs. Remember that Law 9.074/95 has forbidden the execution of works and services by means of grant and permission of public service without a law establishing conditions - such requirement is void only for basic sanitation projects. However, it could be understood that the article 175 of Constitution itself ties the unlocking of common grants to Legislative authorization.

Such authorization will be exempted for PPP programs not involving delegation of public services. As it was said before, there are administrative grant assumptions in which the object is not constituted as public service but as a service merely delivered to the Public Administration. In such cases, it is not required previous Legislative authorization to proceed with the hiring.

{5.2 PREVIOUS LEGISLATION FOR UNLOCKING COMMON GRANTS

The first providence for delegating the public service is the issuance of an act explaining the convenience of the grant or permission (justification), which must also characterize the object, the field and the period for delivering the public service. It is also in this planning phase that studies shall be carried out and the base projects for the grant shall be elaborated, as listed in the examples below. The bid's public notice, the contract minutes and its attachments, which may be made available for public consultation and debate, shall be elaborated in this preliminary phase.

Although the General Grant Act has no express provision mandating public consultation and debate - and the General PPP Act required solely the submission of the bid's notice and contract minutes to public consultation - it is understood that the public debates are mandatory for bid (or a set of bids) with the minimum value of R$ 150 million, similarly to hiring under the Law 8.666/93. For some public services, legislation determines that public consultation and debate are mandatory, such as for granting basic sanitation services (Law 11.445-/2007).

{5.3 PREVIOUS LEGISLATION FOR UNLOCKING PPPS

Within its internal phase, the PPP is conditioned to (i) the formalization of an authorization act explaining the reasons for the project convenience, and technical, economic and financial reasons for using a PPP model; (ii) elaboration of tax and budget demonstrations; (iii) holding a public consultation; (iv) presentation of environmental documentation and studies, which will be explained later. Furthermore, the Public Administration shall elaborate the bid invitation tool (and its attachments) and the PPP contract minutes.

Justifications for the program's convenience and opportunity shall identify all reasons leading to the

selection of a PPP model in relation to other hiring methods, which demands technical, economic and financial analyses. In this regard, it is important to demonstrate the so-called Value for Money (VFM), explaining the reasons through which the PPP model values public money (and bring socio-economic benefits).

In addition to that justification, a series of financial and budgetary demonstrations are required. As PPP programs involve long-term commitment of public resources, tax demonstration are always relevant. In this context, legislation has demanded that the Public Administration estimates the budgetary and financial impact in fiscal years when the PPP contract is valid; a declaration from the expense owner that the obligations due to the Public Administration during the contract are compatible with the Budget Guideline Act and are included in the yearly forecast act; the estimative of public resource flows enough for meeting the obligations taken by the Public Administration during the contract validity.

Remember also that the Federal Administration is not allowed by law to warrant or transfer resources voluntarily to states, the Federal District and cities if the sum of ongoing expenses derived from the set of partnerships already hired by such entities is higher than 5 percent of the net current income in the previous fiscal year or if yearly expenses of valid contracts in the next ten years are higher than 5 percent of the net current income projected for the respective fiscal years.

The object of the PPP must also be forecast in the multiple year plan in force where the contract will be celebrated. Assuming public long-term financial commitments demands that such obligations are reflected in the multiple year plan budget (covering four years).

Still before launching the PPP bid, the bid's notice and contract minutes shall be submitted to public consultation at least for thirty days and be completed seven days before the expected date for posting the bid's notice as a minimum. Such minimum period will allow for the Public Administration to assess propositions and critical analyses submitted in the consultation phase and to provide the due answers, adjustments, and justification. The whole consultation procedure pursues both the publicity of terms and the control of the contract by the people.

As for the public debate, it is strongly recommended that it is carried out when the value of the bid or the set of bids are above R$ 150 million. The public debate aims to allow for the people's participation on building the solution proposed by the Public Administration so that users can provide feedback on the project being bidden.

Finally, it will be necessary that PPP (and grant) programs are equipped with critical studies and projects.

{5.4 STUDIES AND PROJECTS REQUIRED FOR UNLOCKING GRANT AND PPP PROGRAMS

Grant and PPP programs shall necessarily be supported by studies and projects that allow for its full technical and financial characterization.

As a rule, grant and PPP programs will rely on previously elaborated documents below:

(i) legal studies
(ii) operational project
(iii) engineering work pre-project
(iv) demand studies
(v) financial studies
(vi) environmental studies
(vii) other demonstrations and surveys

Legal studies

Legal studies will define the legal model of the Grant or PPP, identifying the contract type selected and meeting requirements and compliance to thresholds determined by the legislation. Such studies will provide PPP or grant full design and also legal support for the program core items (such as public warrant structure, public counter-payment methods, step-in rights and so on). Furthermore, it will be required to examine compliance to several procedural and formal requirements determined by the legislation.

Operational project

The operational project will define all technical aspects related to the operation of the service that is the object of the grant or PPP. This document will guide the service delivery method, technical specifications of required equipment for delivery, user service requirements, work activity and implementation schedule, and the service indicator chart that will be used even to drive the Grantee's remuneration system.

On grants and PPPs, the operational project shall be preferably supported by performance obligations focused on reaching outcomes and not so much on management and means control. For this reason, there is a desired incompleteness on technical definitions considering that the selection and management of raw materials and technologies is under the Grantee's responsibility.

Engineering work pre-project

Whenever the grant requires the execution of works, it will be necessary to make an engineering pre-project available. Completed or finished projects will not be required for unlocking the bid. The studies shall be at the pre-project level and the Grantee is in charge of detailing the projects.

Starting from the fundamental elements for the characterization of the works integrated in the grant (these works are made available under a bid's notice), the Grantee will produce basic and executive projects by the time of the execution of the contract, which will be later assessed and authorized by the Public Administration.

Demand studies

Demand studies are a critical piece in structuring the grant and PPP deals, as they will define one of the more impacting elements in the economic-financial equation of these contracts: demand estimation. This indicator will allow for estimate the business income, aiming to elaborate the economic and financial studies related to the grant. Such estimates become quite relative in greenfield projects due to the natural difficulty to estimate usage levels for infrastructure that does not exist.

Financial studies

It is critical that grant and PPP programs are supported by economic and financial studies indicating the expected return rate for executing the grand and exploration of the venture, which will depend of cost and income projections and the financial profile selected for modelling the contract.

Environmental studies

It is necessary that the grant and PPP program contains studies related to the environmental impacts that the venture may cause, in addition to a report of eventual environmental liabilities that may be transferred to the Grantee. Such studies will contain, as a rule, the assessment of the environmental impact and the identification of potential mitigating measures. It is important that the parties interested in bid the grant or PPP contract be offered the condition of identification of eventual environmental risks related to the program, as well as its economic-financial impacts.

Other demonstrations and surveys

It is always difficult to list and correlate all demonstrations and studies that shall support the structuring of grants and PPPs, as this will depend a great deal of the service and venture nature. In many cases, additional surveys to the studies mentioned above may be necessary, according to the grant peculiarities. Grants and PPPs for highways, as an example, may require surveys related to the expropriation to be made and so on.

FIGURE 5 – SEQUENCE OF STEPS FOR PPP INTERNAL PHASE

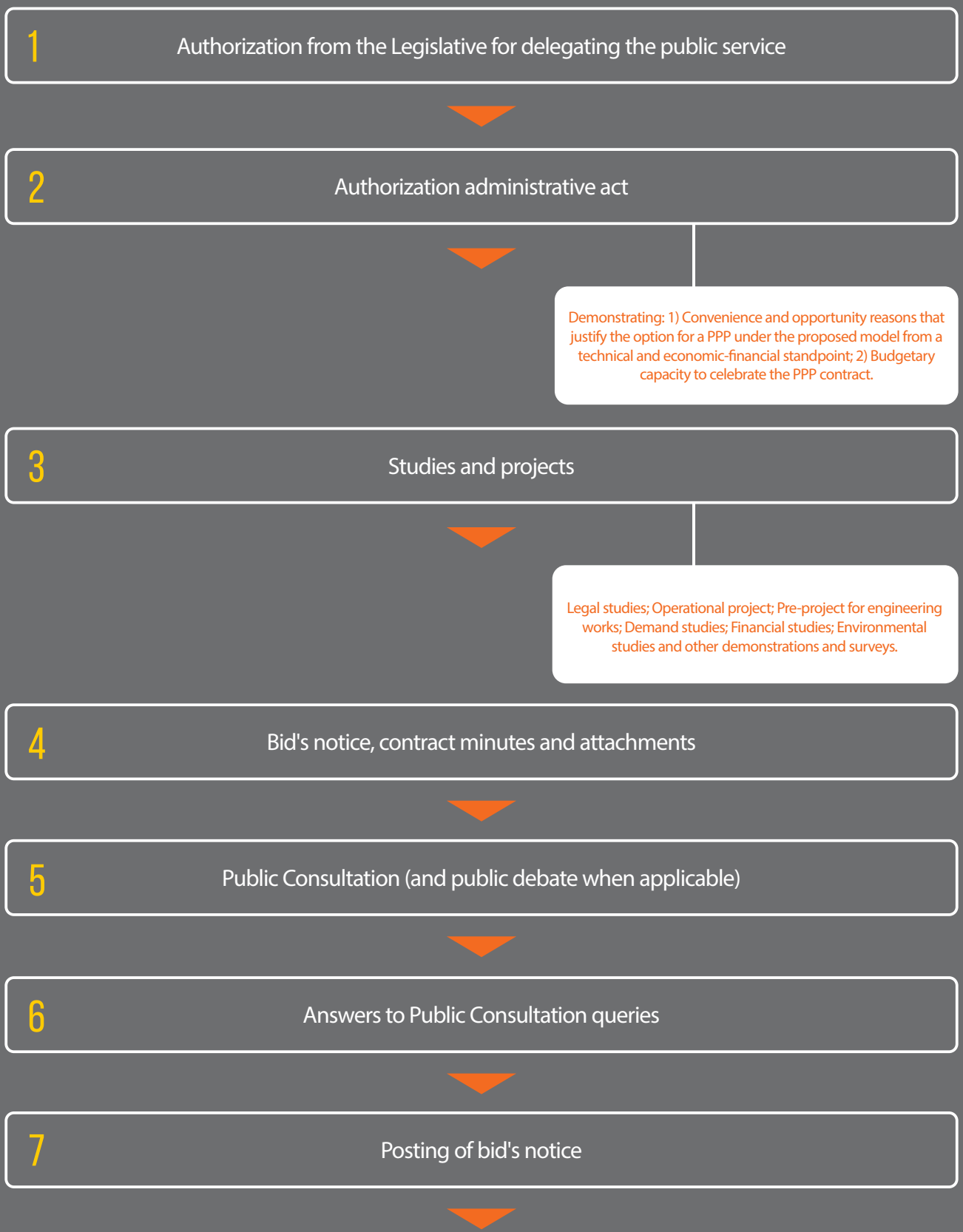


FIGURE 6 – SEQUENCE OF STEPS FOR GRANT INTERNAL PHASE

6. BIDDING

{6.1 REQUIREMENT OF A BID TO HIRE GRANTS AND PPPS

Grants and PPP contracts shall be preceded by a bidding process. The possibility of hiring a grant or a PPP by a direct hiring (without bidding), thus, is rare and exceptional. Some do not even admit such possibility. But there are cases in which the bid may not be required if a competition is not possible or if there is an assumption of exemption. These cases are determined in Law 8.666/93 and are applicable only to specific assumptions related to grants and PPPs. Cases most likely are those of administrative grant not involving "public service". Still, it is not possible to say, theoretically, that all these assumptions of exemption are applicable to administrative PPPs, as there are striking differences between the models that may allow PPPs for the application of rules that authorize exemption as determined by Law 8.666/93.

Processing a bid for a grant or PPP follows a distinct discipline from the one that is determined by Law 8.666/93, albeit such law is applied secondarily. Both the General Grant Act (Law 8.987/95) and the General PPP Act (Law 11.079/2004) established a discipline of their own to biddings, selecting specific modalities, introducing customized selection criteria for these contract models and regulating topics related to the bid processing on its both internal and external phases.

Providences and the steps related to the grant or PPP hiring processing's internal phase were covered before (see Item 5). Topics related to the bid's external phase, involving mainly questions on processing will be addressed below.

{6.2 WHAT ARE THE CHARACTERISTICS OF A BIDDING PROCESS FOR A COMMON GRANT?

Bids for common grant of public services are governed by the Law 8.987/95, which is supported by Law 8.666/93. As grants involve a long-term contract with peculiar, very different characteristics from payment contracts (governed by Law 8.666/-93), although it is possible to consider applying the General Bid Act as a support, using this legislation is conditioned to its compatibility with the common grant of services. This is means that even when the grant legislation goes quiet, it is not appropriated to automatically import interpretations conventionally extracted from the general legislation to these contracts.

Also, legislation specific to the contract's object govern the bid for common grant of public services, as well as legislation on administrative processes (Law 9.784/99).

In relation to the bid's processing, legislation is adamant that a competition is the modality to be followed, although Law 9.074/95 (and other specific pieces of legislation) authorizes the use of the auction modality in some situations. The General Grant Act has also stipulated the possibility of changing the sequence of proposal's homologation and judgment phases (in relation to the conventional schedule that assumes that homologation comes before the proposal's judgment). In this case, when the proposal classification or the bid offering is closed, the envelope with the documents of the bidder better ranked is opened to check compliance to the bid's notice. If the bid's notice conditions are fully complied, the bidder is announced as winner. If the first ranked bidder is not accepted, then the second best ranked bidder's documents are reviewed and so on, until a bidder is found that has fully complied with the conditions determined in the bid's notice. The change of sequence here, inspired by Anatel's Resolution 65/1998 and in the auction model, is not mandatory or preferential over the conventional schedule but only a discretionary option to structure the grant's bid.

The General Grant Act has also created, understandably, new criteria to assess the proposals. The bid may also work with the criteria below: a) lesser fee; b) higher bid as payment of the grant; c) best technical proposal with prices determined in the bid's notice; d) best proposal due to the combination of lesser fee and best technical proposal; e) best proposal due to the combination of higher bid as payment of the grand and best technical proposal; f) higher bid as payment of the grand after qualification of technical proposals.

The definition of the best suited criterion is discretionary of the Public Administration, who shall

consider the object's characteristics and the peculiarities of the market competing for the grant. The selected criterion must be compatible with the object of the grant, which might become more difficult due to the application of technical criteria (involving qualitative assessment of technical proposals). Anyway, the definition of proposal selection criteria will depend on the analysis of real-world cases as it is difficult to determine abstract parameters to guide such assessment.

{6.3 WHAT ARE THE CHARACTERISTICS OF A BIDDING PROCESS FOR A PPP?

The bid for comprising the public-private partnership is governed by Law 11.079/04 and supported by Law 8.987/95 and Law 8.666/93.

Here, the legislation on public hiring is also a supporting tool, as the General Bid Act (and the General Grant Act) will be only applicable with compatible with the PPP model's characteristics.

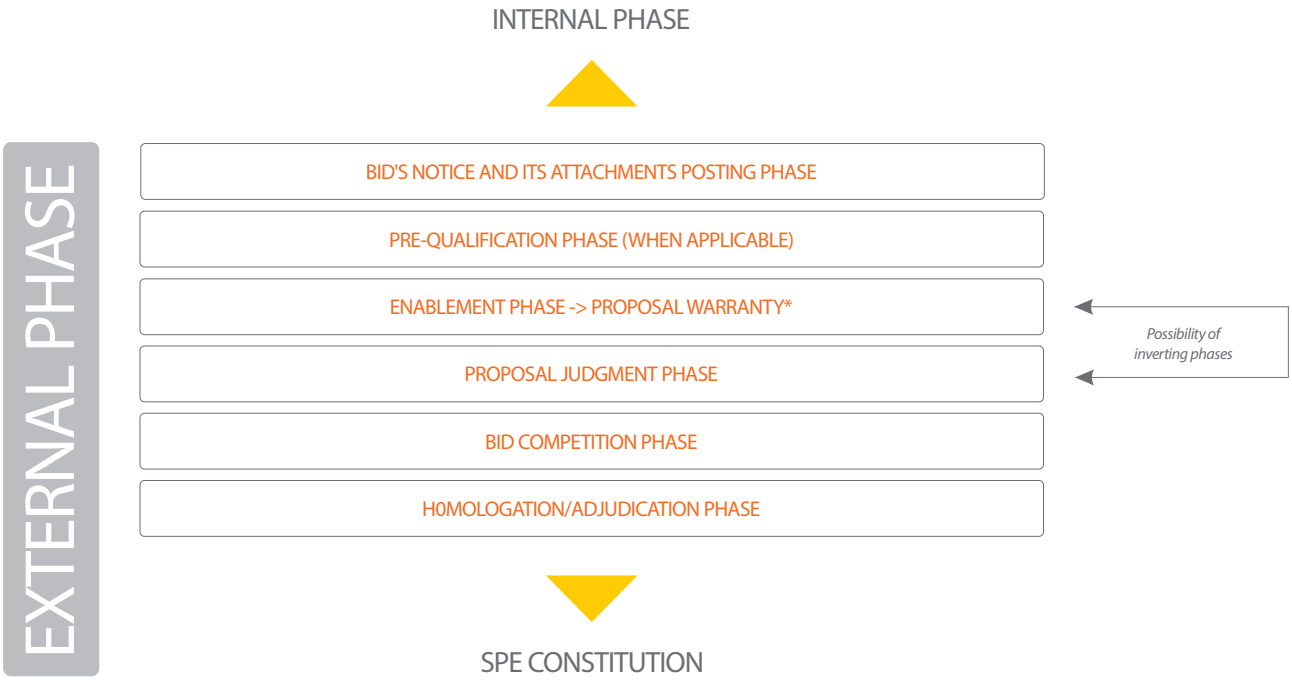
As for processing, the General PPP Act, similarly to the General Grant Act, imposes the competition modality and also allowing for altering the sequence of phases. It has allowed as well that the judgment is preceded by a step to qualify technical proposals - where bidders failing to reach a minimum score will be eliminated from the bid.

Furthermore, the PPP legislation accepts that open competition model, that allows bidders to convey their proposals by voice. It was admitted by the submission of economic proposals inside a closed enveloped and in the closed-open model, when written proposals are submitted first, then bids follow by voice. Participation in the bidding phase may be restricted depending on the disciplined established by the bid's notice, to bidders whose proposal are closer to the lesser bid price (legislation allows that the bid's notice restricts the submission of bids by voice to bidders whose written proposal is at least twenty percent higher than the price of the best proposal). The goal of establishing such restriction is to encourage bidders to offer competitive prices in the written proposals (closed mode), to mitigate the risk if adjudicating higher prices if there is no competition.

As for judgment criteria, PPP bids can be governed by the following criteria: (i) lesser fee of the public service to be delivered; (ii) best proposal due to the combination of lesser fee of the public service to be delivered with the best technical proposal; (iii) lesser value of counter-payment to be paid by the Public Administration; or (iv) best proposal due to the combination of lesser value of the public counter-payment with the best technical proposal, according to the weights determined by the bid's notice.

In relation to the remediation of eventual issues, the Law still stipulates that proposals can fix inadequacies or be formally corrected within the period determined in the bid's notice.

FIGURE 7 - PPP BID EXTERNAL PHASE DEVELOPMENT



*The Proposal Warrant will integrate the homologation documents (and will be disclosed and reviewed along with the homologation documentation). In the case of inverting phases, the envelope containing the proposal warrant will be submitted and opened before starting the phase of proposal judgment.

7. RISK MATRIX

{7.1 DEFINITION OF A RISK MATRIX AND ITS RELEVANCE FOR THE CHARACTERIZATION OF GRANT OR PPP FINANCIAL-ECONOMIC EQUATION

The risk matrix is one of the critical elements of the grant and PPP contract. It identifies all risks involved in the contract's execution, allocating such risks to the responsibility of each party. Once the risk matrix is defined within the contract, eventual realization of such risks along the grant's execution will be called upon the responsible party, which will bear the losses derived. Thus, the risk matrix is at the core of the economic-financial equation of a grant or PPP contract.

Managing the balance of effects of such matrix will ensure the maintenance of the contract's economic-financial equilibrium. Whenever the Grantee suffers a loss derived from the realization of a risk allocated under the Public Administration responsibility (such as increase of the tax burden upon the contract production costs), the Public Administration shall pay the Grantee back according to the terms determined in the contract (adjusting the economic-financial equation first defined).

For this reason, the risk matrix is a critical piece in administrative contracts in general and becomes even more relevant in complex, long-term contracts such as grant and PPP contracts.

In order to define the risk matrix of such contracts, there are legal rules and economic assumptions to be followed. The legal discipline is not specific about this topic and does not impose a previously defined risk allocation. Only in very specific cases, such as the risk of inflation or change of tax structure and legal charges or contract's object change by the Grantor, the legislation has defined a certain risk allocation. Furthermore, the General PPP Act has determined that benefits derived from the credit risk mitigation of financing used by the private partner shall be shared with the public partner. As for the rest, the Law covers the topic only in a principle-based mode: the allocation of risks shall follow the efficiency principle as it is one of the contract's efficiency gauging tools. In order to allocate risks efficiently, it is necessary to follow some critical economic assumptions, as commented ahead.

{7.2 HOW ARE RISKS ALLOCATED INTO GRANT AND PPP CONTRACTS?

Of course that risk allocation under the responsibility of one party will impact the cost structure of the grant or PPP contract. This is because the parties under a contract charge for taking risks, and such precification will vary according the risk is allocated to a party or another, once parties have different capacities and aptitudes to absorb risks or deal with the consequences of a risk realization. This way, the hiring will be as economic as the risks are allocated to the party which will manage to absorb such risks at lower costs. For this reason, the core economic assumption guiding the definition of a risk matrix is the allocation of risk to the party that would effectively charge less to deal with it, as this would help to reduce overall costs incurred in the hiring.

Such risk management capacity involves both the aptitude to prevent risks (the party best equipped to avoid risks) and its condition to minimize losses if the risk is realized.

Insurance is a widely used tool to prevent risks. Having insurance policies in the markets at an affordable cost for certain risks may facilitate risk allocation to the private partner.

In the other hand, risks against which the Grantee has no protection (including for a lack of insurance affordable and available in the market) shall always be placed under the Public Administration responsibility.

{7.3 SHARING THE RISK OF DEMAND (ESPECIALLY IN GREENFIELD PROJECTS)

Sharing the demand risk between the public partner and the private partner is a method being used by many Grant projects. The purpose of such sharing is to share unexpected gains and losses that may be derived from the variation of the demand that was first forecast. It works as a hedging tool for the parties in relation to the inefficiency and inconsistency risks of the demand studies that were supporting the grant or PPP program.

Sharing the demand risks becomes more relevant in greenfield projects, when demand estimates have significant margins of error, as it is always difficult to estimate usage levels of infrastructures that do not exist.

Risk sharing equations may vary. It is important to find demand variation ranges that provide the safety expected by the Grantee (and the program's investors and financing entities) to prevent acute losses derived from demand levels that are way below to those estimated (negative risk) and also, in the other hand, extraordinary and excessive gains for the Grantee caused by demand levels above the estimation (positive risk). Sharing the demand risk may, thus, help to reduce transaction costs, generating economies for hiring a grant and a PPP.

FIGURE 8 - EXAMPLE OF A RISK MATRIX

Risk	Definition	Allocation	Consequence	Mitigation
Works.	Not meeting the schedule – change to the project under private partner and public entities request – wrong time and cost estimates – geological problems (it is possible to foresee geological problems before the construction starts, but its extension remains unknown).	Private.	Contract-based fines, contract early termination, and demand of warranties	Selection of Grantee with full capacity to properly meet all contract provisions. Rules and deadlines for submitting a basic project before construction, non-objection and submission of project as built. Deadline for all items, including non-objection – definition of procedure. Request to change the project by the private partner does not generates contract rebalance. New works require rebalance and approval from the Grantee (a procedure should be established for that). The Grantee is responsible for geological and geotechnical studies. The works are carried out by the Grantee's sole risk. Performing studies before the bid and visiting the project's site may mitigate the risk of a geological problem's higher costs. Definition of fines in case of delay to the works. Warranty for executing the contract. Provision for an Insurance Plan for Engineering risks and so on. It must be clearly stated that dates of start and conclusion will be met. It may be established that the start date may be pushed back for preventing force majeure or other unplanned event, but it never can be postponed. Changes to the work schedule may be considered as a form of rebalance.
Lack of compliance of the work with its approval.	Non-conformity of the construction (including hidden vices) with the contract's provision.	Private.	Delay and related costs.	Compliance to the basic project and executive project elaborated by the Grantee as approved by the Grantor. Definition of fines and penalties.
Financial liquidity issues in the construction.	Private partner is having cash flow problems preventing the continuation of works.	Private.	Fine Step-in rights	Submission of cost surveys and source of resources at the celebration of Grant Contract. Homologation and financial performance indicators requirements. Definition of fines. Provision to pay bonus for good financial indicators.

Risk	Definition	Allocation	Consequence	Mitigation
Delays for obtaining permissions (including environmental ones).	Delay for obtaining permissions caused by the private partner.	Private.	Contract-based fines, contract early termination and demand of warranties.	The Grantor may issue a guideline for granting environmental permission for the venture as per applicable regulations. There must be a contract provision for the Grantee's fulfillment of federal, state and city regulations about permissions/authorizations under time and fashion. Demand of a warranty for strict compliance with contract obligations, fine and contract early termination. Irrespective of the period determined by legislation for granting an environmental permit, the Grantee shall submit the legal documentation at least 180 days before the construction starting date, as well as to be present at the on-site reviews by governmental environment agencies.
Error in the construction costs estimates or work duration estimates, with price increase of core materials/workforce.	Error in the construction costs estimates or work duration estimates, with price increase of core materials/workforce causing higher costs, except those incurring directly from tax changes or public policies.	Private.	Additional costs. Delays and costs related.	The Grantee is responsible for the project and the construction. The contract shall estipulate that there will be no rebalance in such cases. Determine a construction development indicator.
Delay on transferring service management to the Grantee.	Delays beyond expectation on delivery of existing facilities, generating costs.	Public.	Economic-financial rebalance; Contract termination.	Transference of the system to occur at the moment of signature of contract, with proof of receipt signed by the SPE. If delay exceeds 1 year, termination is possible.
Delay on conclusion of new works.	Delay on conclusion of new works.	Public.	Implicit approval.	It will be considered as approved by statutory time.
Material errors in the construction.	Errors on executing the construction by the Grantee, causing losses due to total or partial rebuilding	Private.	Poor quality on service delivery, fines, contract early termination and demand of warranties.	The Grantee is responsible for the project and the work.
Schedule changed by the Public Administration.	Changes to the construction schedule made by the Public Administration.	Public.	Possibility of additional costs.	Contract provision for contract's economic-financial rebalance.
Schedule changed by the Grantee.	Changes to the construction schedule made by the Grantee.	Private.	Possibility of additional costs.	Requests for pushing the schedule back are submitted to t he Public Administration's approval. Possibility of applying fines for delays.
Unexpected event or force majeure (possible insurance).	Events considered as unexpected or force majeure that prevent continuity or conclusion of works/service or reaching the goals demanded.	Private.	Loss or damages to assets, loss of revenues, delays to the works and disruption of service delivery	In some cases, insurance can be acquired against unexpected events or force majeure
Unexpected event or force majeure (not insured or premium value not compatible with project's cash flow).	Events considered as unexpected or force majeure that prevent continuity or conclusion of works/service or reaching the goals demanded.	Public.	Loss or damages to assets, loss of revenues, delays to the works and disruption of service delivery	For cases where it is not possible to buy insurance (in Brazil) on reasonable conditions (not compromising the business plan), the risk will be taken by the Public Administration by means of rebalancing contract's economic-financial equilibrium.

SOURCE: Simplified scheme for allocating risks on building under a PPPS extracted from the Key Rule Standardization Manual for Private-Public Partnerships of the State of Minas Gerais Government. (http://ppp.mg.gov.br/manual/livro.htm)

8.WARRANTIES

{8.1 PUBLIC WARRANTIES AND PRIVATE WARRANTIES

Grant and PPP contracts will demand, in all cases, warranties and insurance policies from the Grantee in relation to fulfillment of certain charges. This topic has been object of regulation by regulating bodies.

Whenever the object of the grant involves the execution of a work, warranties limited to the value of the work are demanded for this specific part of the grant. Furthermore, it is custom to demand diverse insurance policies aiming to hedge the Grantor against the risks involved in executing the grant or PPP (such as performance insurance - performance bond, civil liability insurance for engineering work risks, civil liability insurance for operational risks and so on). There are diverse insurance modalities that may be required on granting programs, which will depend on the nature of deliveries related to the grant's object.

In addition to the warranties to be provided by the Grantee, PPP contracts may also require public warranties structured by the public partner to hedge the private partner against the payment of public counter-payments (and other credits originated by the grant). The public warranty shall be delivered under several warranty modalities, such as indicated ahead.

All public warranties, as well as the events that will trigger their execution by the Grantee, shall be fully indicated and described in the PPP contract.

According to the legislation (item IV of article 5 of Law 11.079/2004), PPP contracts shall forecast the events that define public partner's default, methods and deadlines for regularization and the trigger method, if applicable. Thus, the contract shall estipulate not only an objective description of behaviors defining public partner's default but also define the moment when the warranty may be triggered and the procedures regulating such triggering.

Please note that not only the fulfillment of public counter-payment can be insured by a public warranty, but also other obligations that may fall under the Grantee's responsibility such as the payment of indemnifications derived from the realization of risks that were allocated under its responsibility or the premature extinction of the contract due to takeover, among other causes.

{8.2 MODALITIES OF PUBLIC WARRANT

Legislation has determined some public warranty modalities, including: (i) revenue binding (except for tax-based income binding and the impossibility of pledging public revenue); (ii) institution or usage of special funds allowed by legislation; (iii) purchasing warranty-insurance with insurers not controlled by the Public Administration; (iv) warranty delivered by international entities or financial institutions not under Public Administration control; (v) warranties delivered by a warranty fund or state-owned entity created for this purpose; and (vi) other mechanisms allowed by law. Such list is not limited or exhaustive - it is just an example. It is perfectly possible that other warranty modalities be used by the Public Administration in PPP contracts.

A warranty method gaining popularity for structuring PPP programs is the warranty fund or warranty entity. When used for this purpose, such entities shall own assets (transferred, for instance, from Public Administration and from its entities) enough to warrant PPP contracts. The warrant fund shall be a corporation (on private rights), which means that it may be subject to rights and obligations, as opposed to a merely financial fund, which does not have such quality. The goal of setting up the fund as a corporation is to allow that it takes on its own behalf, as a guarantor, obligations taken by direct Public Administration in PPP contracts. If this is the case, when the Public Administration enters default, the Grantee (SPE) may action the fund directly, free from subjecting to the system of government-debt bonds issued as a consequence of court ruling. It is worth remembering that due to Brazil's constitution, all public entities (Federal entities, Federal District and state entities, cities entities and their respective autarchies) are submitted to the government-debt issued as a consequence of court ruling. For this reason, credits recognized by courts against the Public Administration are mandatorily subjected to such government-debt issuance. This condition helps to increase transaction costs as delays the receipt of credits from the Administration. Precisely to work around this problem, the legislation has allowed for the possibility of state-owned funds or companies to serve as guarantor agents. If the fund is a private legal entity, it can be demanded directly by the Grantee like a civil execution, and not being subject to government-debt bonds issued as a consequence of court ruling.

The Federal Administration, such as several states and cities, has structured warranty funds for this purpose (the Federal Administration owns the PPP Guarantor Fund, created by Law 11.079/2004, and the Infrastructure Guarantor Fund that is managed by the Brazilian Guarantor Fund and Warranty Management Office).

Structuring public warranties in PPP contracts, as a rule, will involve multiple warranty types depending on the project's aspects (for instance, setting apart in an escrow resources from transfers addressed to Public Administration or the pledge on credit bonds, among others). The main takeaway is that public warranties are effective and liquid enough to hedge the private partner in relation to the risks of default from the public partner.

{8.3 RELEVANCE AND IMPACT OF PUBLIC WARRANTIES ON PPP FINANCIAL COSTS

Public warranties have a relevant role on structuring grant and PPP programs. Remember that Public Administration hiring processes were always characterized by high transaction costs caused not only due to certain quirks of its legal system (like the issuance of government-bonds as a consequence of a court ruling, for instance) but also from the situation of its contract-based debt. This way, in order to attract private investments in infrastructure under a PPP model, it was necessary to hedge the private partner against the risk of public default by integrating public warranties to PPP contracts. Hence the General PPP Act has expressly determined such possibility (which was unseen on administrative contracts until then).

It is clear, thus, that the quality and efficacy of public warranties will impact the PPP's financial costs. The care with which Public Administration shall deal with the structuring of warranties suited to PPP programs reflect the concern with the reduction of its financial costs, generating economies to the user and to society. This is because as the program's legal risks are reduced, also lesser financing costs will be. Financing institutions will consider modalities, liquidity and efficacy of public warranties integrated to the PPP in order to define financing rates.

Although it is correct to say that public warranties cause the reduction of financial costs to programs in all cases, such warranties may not be always feasible. In a context of lack of available and proper public assets to comprise effective warranties to meet the number of desired partnerships - which is true especially for states and cities - it may be convenient to opt for structures that prevent the concentration of investments in works and assets (CAPEX) at the beginning of the PPP execution, diluting such investments over the contract execution period as much as possible. In the same sense, celebrating PPP contracts by administrative entities

with private legal character, instead of celebrating such contracts directly by the Public Administration, whenever possible, eliminates the risk of submission to the regime of government-debt issued as a consequence of court ruling. Such measures are able to reduce private capital exposure to risk, improving conditions for financing the project.

{8.4 WHAT ARE THE WARRANTIES TO THE FINANCING PART?

Both PPP legislation and the grant legislation have established mechanisms that aim to hedge financing institutions against default risks by the private partner.

One of such mechanisms is the so-called step-in right (also covered on Item 10.5). This relates to the possibility that the financing institution takes control or the temporary management of the SPE if the financing enters default. The "step-in right" aims to restructure the grant in financial terms and to ensure the continuity of service delivery as explained ahead.

The SPE control is defined by the legislation as the resoluble ownership of shares or quotas by its financing institutions and guarantors meeting legislation requirements that govern the share-based partnerships (Law 6.404/76). What was once termed as SPE temporary administration by its financing institutions and guarantors will take place when, without transfers of stocks or quotas, given powers are granted to them to ensure they can make strategic decisions as defined by the legislation.

In addition to the "step-in", PPP legislation also accepted the possibility of issuing pledges in behalf of financing institutions for the project over Public Administration's cash obligations, as well as the possibility that the project's financial institutions are indemnified due to the contract's early termination, as well as payments made by state-owned funds and companies that guarantee public-private partnerships. The issuance of pledges directly in behalf of the financing institution is a relevant warranty to the project finance as it leads revenues from the grant to direct payment to the financing institution or it allows the financing institution to manage these resources directly to the financing accounts.

9. PROCEDURE FOR EXPRESSING INTEREST

{9.1 WHAT IS A PMI AND HOW DOES IT WORK?

A PMI is a procedure through which Public Administration obtains studies, projects and surveys from the private initiative to support a future grant or PPP program. This is a procedure being used as a one step before the structuring of grants and PPP, sometimes launched by the private initiative and sometimes initiated by the Public Administration itself.

A PMI may originate from a public request for companies to submit studies, projects, surveys, investigations and so on, as it may, in some cases, depend on local legislation, derive from an unsolicited and independent manifestation from companies - where, depending on the regulation, such processing will require a public request to provide publicity and ensure the opportunity for other interested parties to express equivalent propositions.

This allows one to classify both types into natural PMI, that is formalized under a Public Administration request, and induced PMI, that arises from the private initiative manifestation (also called unsolicited proposals). Brazilian legislation has not established more specific aspects for PMIs, leaving its regulation for regional and local legislation. In addition to the Federal Administration, that issued Decree # 8.428/2015 for this purpose, a great deal of states and cities already have legislation on PMI. It is the case of the states of Minas Gerais (Decree 44.565/-07), Ceará (Decree 30.328/10), Rio de Janeiro (Decree 43.277/-11), Bahia (Decree 12.653/11, changed by Decree 12.679/11), Espírito Santo (Decree 2.889/11, chan-ged by Decree 2.889-R); São Paulo (Decree 61.371/-15), Paraná (Decree 6,823/12), Santa Catarina (Decree 962/12), among others.

{9.2 PMI PROCESSING

Due to the lack of a specific discipline on PMI in the Brazilian legislation, its processing is being regulated by regional or local legislation. Hence, there are several PMI models, which makes a review

on its structure and processing harder. Anyway, it is possible to find some common aspects on PMI models being customized by states and cities, as explained later.

From a procedural standpoint, a PMI comprises the following phases: (i) communication of request and invitation of submission of material from companies; (ii) analyses of such materials and definition of the selected project; and (iii) incorporation and use of the material submitted, with the definition of reimbursing the company for transferring the rights on the project. If it is successful, the PMI will then instruct and support a PPP or grant bid process, to which the project author may join as a rule.

If the legislation does not place any restriction, it is perfectly possible that the author of the project created for a PMI can join the bid that arose from it. Such possibility is granted by the Federal legislation (article 31 of Law 9.074/95).

As a rule, the PMI will not imply in any obligation for the Public Administration until the selection and homologation act for the submitted material and it is authorized by the private stakeholder. In this case, considering also the partial or total use of the material submitted for instructing or supporting the PPP or grant hiring process, the Public Administration or the bidder than carried the bid process have the obligation to reimburse the material's author, since a reimbursement commitment was specified in the bid's notice. Such definitions will depend on how the PMI is regulated by the Public Administration.

Although the model that has traditionally been favored by regional or local administrations is the one which allows for the participation of multiple stakeholders that may have to grant permission to develop studies and projects within a PMI, some more recent regulation have accepted that the authorization is made for a single company, which would be forbidden to join the subsequent bidding process.

{9.3 ASSUMPTIONS FOR UNLOCKING PMI

Developing a PMI depends, above all, of a preexistence of a proper institutional and regulatory framework that provides stability and predictability. The Public Administration shall have deployed legislation on the conditions for opening and processing a PMI.

Such discipline may be derived both from legislation and infra-legal acts. It has been common that Federation entities pass their laws on grants and PPP, regulating PMI by issuing decrees. Such normative acts are careful to define the structure through which the PMI will be processed, as well as to establish its modalities and the discipline for the proposition, processing and judgment.

Second, it is highly recommendable that the PMI arises as a consequence of administrative planning. The risk of the PMI to render ineffective is directly associated to its autonomous development, independent from a previous administrative planning. The administrative decision to use such type of procedure, alternatively to the production of studies by the Public Administration itself or by hiring external consultants, shall be founded in assessments that are in harmony with the administrative planning.

Finally, the Public Administration needs to be properly qualified (whether by their own employees or external consulting firm) to analyze studies, surveys and projects that may be produced and submitted by the private initiative within the PMI. The technical acumen of Public Administration to interact with interested entities (and authorized parties) about the technical and financial consistency of solutions proposed is a condition that minimizes the risk of capture of public interest by the private one.

FIGURE 9 - PMI SCHEME BY REQUEST

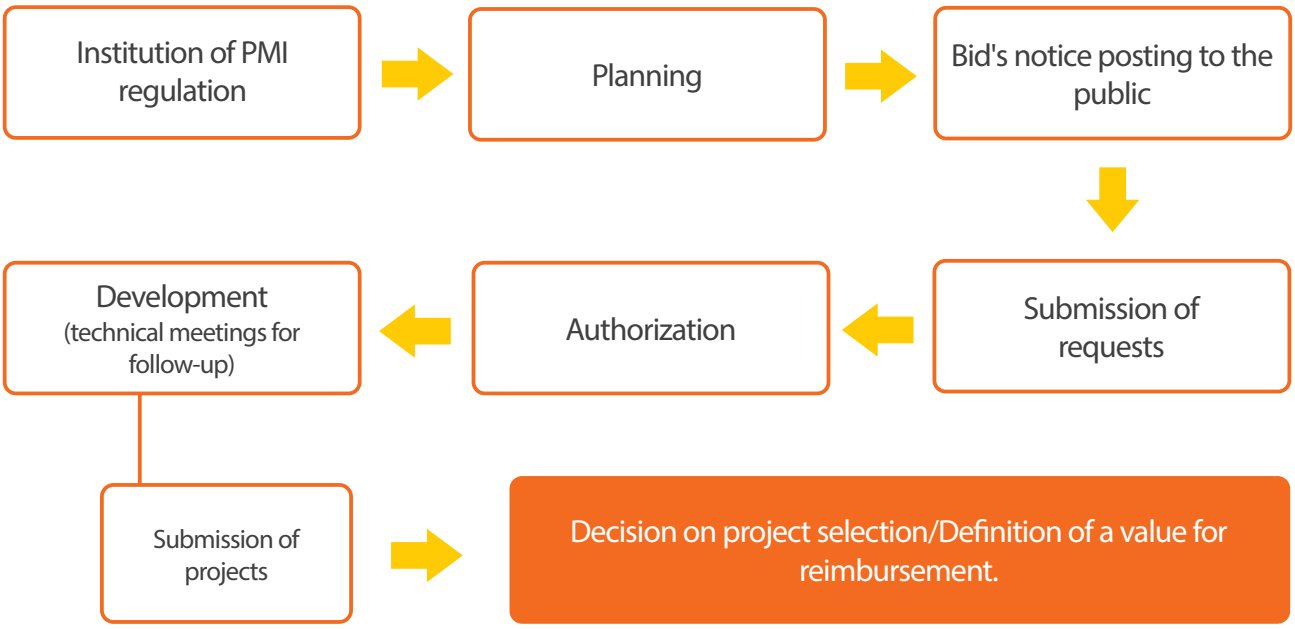
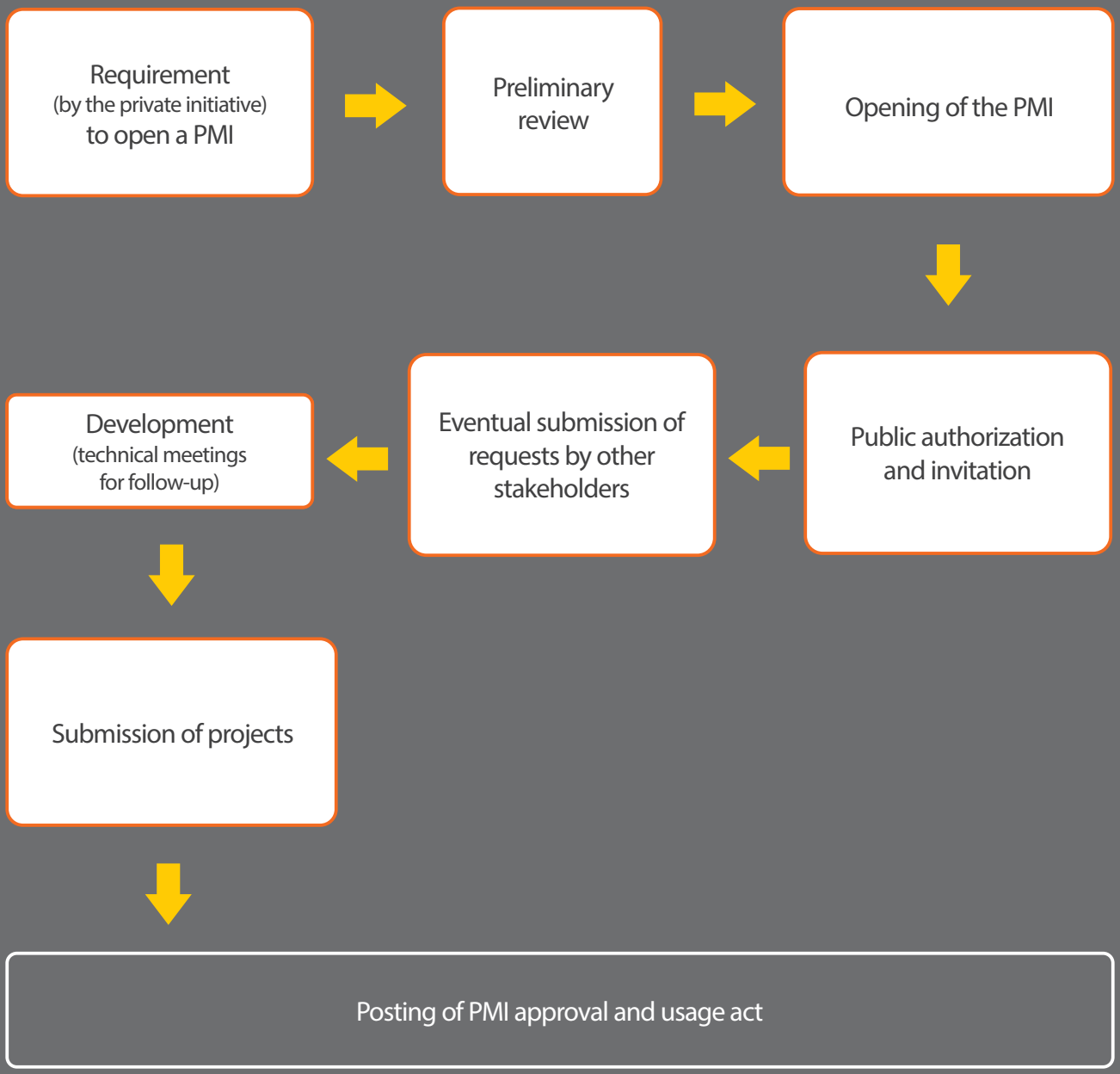


FIGURE 10 – PMI BY REQUEST SCHEME



10. SPECIFIC PURPOSE ENTITY (SPE)

{10.1 CONSTITUTING A SPE FOR EXECUTING A GRANT OR PPP

The legislation governing common grants allows, but do not demand to, that the bid's public notice determines a condition by which the contract will be signed if the winning company establishes a Specific Purpose Entity for operating the grant. Such SPE will be a partnership created specifically and solely to manage the grant, preventing that other businesses of the company may contaminate its execution.

The Public-Private Partnership regime went further and determined that the winner of the bid must establish a Specific Purpose Entity (SPE) for celebrating and executing the PPP contract.

The goal for this law demand is, as said before, to ensure that the PPP is managed by a company solely established for this purpose, segregating the PPP from other company's businesses or from the group of companies that won the bid. Such segregation occurs to exempt the Public Administration and the PPP from the risks that may stem from the involvement of the Grantee in other businesses, to improve governance factors and to facilitate oversighting control that the Grantee shall exercise upon the SPE. Furthermore, by segregating the grant risks from the risks of the Grantee's other businesses, a SPE ends up improving the financing conditions for executing the PPP.

{10.2 ASPECTS OF OWNERSHIP STRUCTURE

There is no direct indication in Brazilian Law about the legal form to be adopted by the SPE or, yet, specific rules on its ownership structure. Thus, there is the possibility that the Specific Purpose Entity may be established under any of the ownership structures available in the Brazilian Legal System. However, it is customary that the SPE takes the form of a stock corporation that may go public, getting financing from the stock market (alternatively to the financial market).

To be considered a SPE, the company needs that

the social object is precisely determined and individualized, matching the broader object of the grant. In addition, the SPE duration shall be strictly related to the execution of the social object (execution of objects inherent to the grant or PPP) since the SPE must be dissolved upon completion of its social activities.

This is a material difference for the SPE against other corporations. Companies are usually established to perpetuate their activities over time - this is the core of the business thinking. But SPEs tend to fold upon the execution of their social object.

{10.3 MINIMUM CAPITAL STOCK AND FULL PAYMENT

It is uncommon to find the definition of a minimum capital stock in the business legislation for business partnerships - there is only the indication that the capital stock shall be adjusted to the activity to be executed. However, it is customary, and perfectly feasible, that the public notices for grants and PPPs require that the SPE acquire a giver minimum capital stock. It is also common that the bid's inviting act governs the capital payment structure until it reaches a certain level. Demands and conditions of these types are related to the SPE's economic-financial capacity sufficiency to execute the grant or the PPP.

{10.4 CHANGES TO THE SPE OWNERSHIP STRUCTURE

The SPE is controlled by the company (or companies) that won the bid, and as a rule, any changes to its ownership structure must be agreed by the Public Administration. Such limitation for changing the ownership structure arises from the peculiarities of the Public Law regime that governs the execution of grants and PPPs. . Precisely because controlling companies and SPE entities are those who won the bid, replacements must ensure that new controlling company meets the conditions of the bid's homologation. Otherwise, there would be room to void the bid goals by simply replacing the compa-

nies comprising the SPE. A SPE is the result of a selection process carried out by a bid, so that the members had to prove they can meet several criteria determined by the Public Administration. Thus, changes to the ownership of a SPE shall be checked against the technical, legal, and economic-financial equivalent of the entrant partner. For this reason, in order to change SPE ownership requires more than meet the specific partnership regime, but also to meet homologation requirements of the bid that generated the grant or PPP hiring. The transferal of stocks is relatively a free deal within stock corporations, but the matter is strictly regulated under a PPP regime as any changes to the ownership structure of a SPE requires previous approval by the Public Administration (similar to what takes place at the social quote transfers in limited partnerships).

{10.5 STEP IN RIGHT

Legislation for grants and PPPs has recognized the so-called "step-in right". This is the possibility of the financing institution to take control (or a temporary administration) of the SPE if the financing obligations enter default. In other words: if the Grantee defaults their financing obligations, the financing institution can take control of the SPE to financially restructure the entity. The step-in right works as a mechanism to hedge the financing institution against such risks, ensuring the SPE continuity and therefore, the execution of the grant. This topic was covered in Item 8.4.

The step-in right performs two relevant roles. First, it reinforces the warranties of institutions financing the grant or PPP project, reducing financing costs. Minimizing financing institution risk helps to reduce the financing costs, also diminishing transaction costs in the grant or PPP contract. Thus, and for this reason, it is desirable that grant and PPP contracts establish step-in rights by specifying all assumptions and conditions to be exercised by the financing institution.

Second, the step-in right is able to ensure the continuity of the grant or PPP. This is a means to allow for restructuring the SPE in charge of the grant, aiming to ensure the continuity of service delivery. For this reason, the step-in right also works beyond the interests of the financing institution, as a warranty for the Public Administration itself.

In order to exercise the step-in right, the legislation requires that financing institutions taking

of the SPE meet the legal and tax requirements demanded in the bid, and the Grantor may exempt or change technical or economic-financial qualification requirements. It makes a lot of sense to void such requirements and conditions as the step-in right does not mean an ordinary transfer of the grant by a mere convenience of the Grantee, but an assumption of granting a controlling stake - or temporary administration - to an institution or company that provided financing to the project.

Due to the grant and PPP restructuring, this is relevant to the public interests and to the Public Administration. Furthermore, it is worth noting that such control of a DPV is temporary and ad-hoc, aiming just to allow for a financial restructure of the grant. This happens because the financing institutions will not be usually entities specialized in the operation of a grant or a PPP. This is why the temporary control or administration of the SPE is always an exception. For this reason, it is convenient that grant and PPP contracts establish also a step-out - i.e., procedures and conditions that would allow for a temporary controller to be succeeded by a specialized operator. The step-out means the transfer of control to a specialized operator who is fully able to manage the grant during the whole of its remaining period.

It should be noted that the legislation does not specify procedures, assumptions and conditions for exercising both step-in and step-out. This discipline will be taken care of in the grant or PPP contract. It is important, however, that all conditions are described in details in the contract, avoiding omissions and uncertainties on this matter, as it is a topic with a strong impact in the grant or PPP financial costs. Again, there is a caveat - warranties like this help to reduce financing costs, generating benefits for the Public Administration and for the service users.

It will be necessary, as said before, that the Public Administration formalize its agreement to allow for the financing institution to exercise such right. But this does not mean that the step-in is conditioned to a discretionary analysis by the administrator. Conditions and assumptions for exercising this right will be described in the grant or PPP contract, and the Public Administration authorization and agreement are dependent on meeting these requirements. It is said that the administrative competence, in this case, is of binding nature and not discretionary nature. In other words: since there are conditions and assumptions, the Public Administration is not able to deny approval or authorization for the financing institution to take control.

11. CONFLICT RESOLUTION

{11.1 MEDIATION AND ARBITRAGE ON GRANTS AND PPPS

Federal legislation has authorized friendly solutions for contract disputes both for grants and PPPs, which brings us to the issue of mediation and arbitrage.

When established in the grant or PPP contract, mediation has been used as a method to clear ad-hoc disputes related to specific topics, usually carried out by a subject matter expert or a technical committee appointed in the contract. It is common that many future decisions related to the execution or extinction of the grant depend on unanimous agreements as determined in the contract. For these cases, an eventual impasse may be overcoming through mediation, established in contract as a mechanism to overcome disputes and allow for such definitions are established without the dispute stemming to other areas. In relation to the position of the Grantor, it would be feasible to adopt mediation for the portion of rights and obligations inserted within interest availability, such as it happens with arbitrage. However, as opposed to arbitrage, the decision of a mediator does not replace legal decision, and the former's decision may be discussed in court later.

Law 8.987/95 also recognized arbitrage as a method to solve disputes derived from the execution of the grant between Grantee and Grantor. Arbitrage benefits are plenty when compared against the conventional method of solving disputes in courtrooms. Its main benefit is to expedite and increase efficiency to the process, consequently generating important economies for the parties - including the Grantor and the public service users. The specialization of the arbitrage panel is another aspect that may help to improve the judgment's quality.

Furthermore, the presence of an arbitrage provision in the contract minutes may reduce transaction costs for hiring the grant, reducing overall costs for bids.

Thus, it is desirable that the arbitrage is elected as the method for solving disputes in grant and PPP contract minutes. However, many Public Administration entities are resistant against adopting arbitrage. The main legal obstacle mentioned is the impossibility of use for discussing unavailable issues or rights (due to the restriction placed by the arbitrage legislation itself). And such impossibility becomes more feasible when the concept of unavailability is expanded, which frequently occurs for examining the problem. Remember that the grant is a contract that one might call hybrid. It involves statutory or regulation aspects and typically contract-based aspects. From this opposition, it would be possible to say that all issues on the grant contract are perfectly able to be solved by

arbitrage; otherwise, issues related to regulation or statutory aspects would have to be argued in the Judiciary.

Trying to better set boundaries to this thematic division, it would be possible to say that arbitrage is perfectly possible and feasible to solve disputes on: (i) factual issues; (ii) technical issues, including those which should be assessed by subject matter experts; (iii) issues derived from the contents in the grant contract that are not related to unavailable rights; (iv) controversies on the risk matrix established in the contract; (v) issues related to service levels being met or not by the Grantee as defined in contract; (vi) recovery of the economic-financial equation for the grant; (vii) economic-financial provisions in the grant contract; (viii) indemnification due to the Grantee or to Grantor; (ix) issues related to the extinction of the grant, especially those related to contract termination, except those related to state prerogatives.

In the other hand, it is not feasible to submit to arbitrage disputes on the exercise of administrative prerogatives, such as intervention, takeover and expiration, as well as administrative expressions of oversight and change to the grant contents. Likewise, issues associated to voiding the grant (or of the bid that launched the grant) will also not be possible to be solved by arbitrage.

Of course this thematic breakdown is not enough to explain for all cases when arbitrage makes sense. Such definition will depend on the thematic boundaries that define a real dispute. Thus, for instance, the controversy on the assessment and valuation that the Grantor makes of a certain event (such as a Grantee's fault) due to decree intervention or expiration of the grant does not appear to be susceptible to be solved by arbitrage. But if the discussion is about the Grantee not meeting minimum levels of service as determined by the grant contract, as the justification for the Grantor to decree intervention or expiration, then the issue is perfectly susceptible to be submitted to an arbitrage panel. Such controversy on facts or assessments of technical nature involving the Grantee behavior is adept to arbitrage as there is no involvement of unavailable rights.

Be as it may, the important thing is that the arbitrage concept percolates within the Brazilian experience with administrative contracts once and for all. In times when higher efficiency is sought, replacing the Judiciary for the Arbitrage Panel will be an important step ahead.

FIGURE 11 – RELEVANT PPP STATE LAWS*

AMAZONAS

Law 3.322 dated 22 December 2008. Creates the Amazonas State Public-Private Partnership Fund and other measures. ("Public-Private Partnership State Program Management Unit").

Law 3.363 dated December 2008. Covers the Public-Private Partnership State Program and other measures.

Law 3.716 dated February 2012. Changes how Law 3.322 dated 22 December 2008 specifies the creation of the Amazonas State Public-Private Partnership Fund and other measures. ("Public-Private Partnership State Program Management Unit").

Law 3.879 dated May 2013. Changes how Law 3.322 dated 22 December 2008 specifies the creation of the Amazonas State Public-Private Partnership Fund and other measures. ("Public-Private Partnership State Program Management Unit").

Decree 659 dated May 2012. Approves appointments for the Amazonas State Public-Private Partnership Program's Management Council ("Public-Private Partnership State Program Management Unit").

Decree 31756 dated 11 November 2011 – Covers the approval of the Management Council and Management Unit Bylaws for the Amazonas State Public-Private Partnership Program's Management Council ("Public-Private Partnership State Program Management Unit").

Law 3.902 dated 17 July 2013. Changes provisions of Law 3.322 dated 22 December 2008 and authorizes transfer of installments of financial resources from the State and Federal District Participation Fund to the Amazonas State Public-Private Partnership Fund.

BAHIA

Law 12.604 dated 14 December 2012.

Law 12.610 dated 27 December 2012. Authorizes the Executive to create the Bahia State Partnership Guarantor Fund (Fundo Garantidor Baiano de Parcerias, FGBP).

Decree 12.653 dated 28 February 2011. Regulates the Procedure for Expressing Interest (Procedimento de Manifestação de Interesse, PMI) for public-private partnership projects, both in administrative and sponsored modalities, and for common grant and permission projects within State's Public Administration agencies and entities scope.

Decree 9.322 dated 31 January 2005. Covers the allocation in special, remunerated deposits of resources from financial availability from the Work Support Fund (Fundo de Amparo ao Trabalhador, FAT).

Law 11.477 dated 1 July 2009. Authorizes the transfer of installment of resources from the State and Federal District Participation Fund to DESENBAHIA – Bahia Development Office for fulfilling obligations taken by the State of Bahia and its indirect administration entities on public-private partnership contracts according to article 16, paragraph II, of State Law 9.290, dated 27 December 2004, and other measures.

Decree 11.724 dated 22 September 2009.

Law 11.620 dated 14 December 2009.

Instruction SEFAZ Nº 139 dated 26 May 2010. Defines new rules for payment of obligations taken by the State of Bahia and its Indirect Administration entities on public-private partnership contracts according to State Law 11.477 dated 1 July 2009.

ESPÍRITO SANTO

Decree 3.304 dated 9 May 2013. Approves CGP-ES Resolution #4.

Decree 3.138 dated 26 October 2012. Changes Decree 2889/2011.

Decree 2.889 dated 1 November 2011. Creates the Procedure for Expressing Interest.

Decree 307-S dated 2 February 2001. Changes an appointment to the CGP-ES.

Decree 029-S dated 27 December 2010. Covers the PPP-ES Unit's Bylaws.

Decree 868-S dated 26 August 2009. Appoints a Chairman and members of the Espírito Santo State Public-Private Partnership Management Council and other measures.

Supplemental Law 402 dated 10 August 2009. Creates the Espírito Santo State Public-Private Partnership Program and other measures.

PIAUÍ

Law 5.494 dated September 2005. Creates the Piauí State Public-Private Partnership Program and other measures.

Law 5.817 dated December 2008. Changes Law 5.494 dated 19 September 2005 that creates the Piauí State Public-Private Partnership Program.

PERNAMBUCO

Law 12.765 dated December 2005. Covers the State Public-Private Partnership Program and other measures.

Law 12.976 dated January 2005. Creates the State Public-Private Partnership Guarantor Fund and other measures.

Decree 28.844 dated January 2006. Empowers the State Public-Private State Program's Management Council – CGPE as per Law 12.765 dated 27 January 2005 and other measures.

Normative Resolution RN/CGPE-001/2006 dated February 2006. Determines general procedures for logging and approving Feasibility Studies and Basic Projects for Public-Private Partnership Ventures.

Normative Instruction RN/CGPE-001/2006 dated March 2006. Determines concepts, criteria, procedures and competencies for the Public-Private Partnership Operational Coordination Unit – PPP Unit.

Decree 29.348 dated June 2006. Creates the Permanent Bid Committee – CPL/PPP.

Law 13.070 dated July 2006. Includes Public-Private Partnership State Program priority projects in the PPA.

Law 12.994 dated March 2006. Introduces changes to Law 12.976 dated 28 December 2005 and other measures.

Law 13.282 dated August 2007. Changes provisions of Law 12.765 dated 27 January 2005 and of Law 12.976 dated 28 December 2005.

Law 13.954 dated December 2009. Changes State Law 12.765 dated 28 January 2005.

Law 14.339 dated June 2011. Changes Law 12.765 dated 27 January 2005 and its modifications, and covers the Public-Private Partnership State Program, and changes Law 12.976 dated 28 December 2005, and its modifications, that creates the Public-Private Partnership State Guarantor Fund, and other measures.

Law 14.819 dated November 2012. Changes provisions of Law 12.976 dated 28 December 2005 that creates the Public-Private State Guarantor Fund – FGPE.

RIO GRANDE DO SUL

Law 12.234 dated January 2005. Covers the rules for bidding and hiring public-private partnerships, creates the Rio Grande do Sul State Public-Private Program – PPP/RS, and other measures.

Resolution 02 dated April 2013. Establishes Procedures for Expressing Interest, by companies, to submit pre-projects and feasibility studies related to projects within Rio Grande do Sul State Public-Private Partnership Program.

Resolution 01 dated September 2008. Establishes general procedures for logging, selecting and approving basic projects and feasibility studies for ventures aiming for their potential inclusion in the state's public-private partnership program.

RIO DE JANEIRO

Law 5.068 dated July 2007. Creates the Public-Private Partnership State Program – PROPAR.

Law 6.089 dated November 2011. Creates the State Partnership Fund (Fundo Fluminense de Parcerias, FFP), changes provisions of Law 5.068 dated 10 June 2007, that created the Public-Private Partnership State Program, and other measures.

Decree 43.263 dated October 2011. Regulates the Public-Private Partnership State Program Management Council – CG, as per article 6, paragraph 5 of Law 5.068 dated July 2007, and other measures.

Decree 43.277 dated November 2011. Regulates procedures for submission, analyses and usage of proposals, studies, and projects submitted by the private initiative for inclusion on the public-private partnership state program – PROPAR, and other measures.

RONDÔNIA

Law 609 dated February 2001. Creates the Public-Private Partnership in the state of Rondônia.

CEARÁ

Law 14.391 dated 7 July 2009. Establishes rules for bidding and hiring public-private partnerships for the State of Ceará Public Administration, and other measures.

Decree 29.801 dated 10 July 2009. Covers the Public-Private Partnership Management Council.

Decree 30.328 dated 27 September 2010. Creates the Procedure for Expressing Interest in public-private partnership projects, both administrative and sponsored modalities, and in common and permission grant projects.

Decree 30.366 dated 23 November 2010. Changes members of Public-Private Partnership Management Council – CGPPP and of Partnership Technical Entity – GTP.

Regulation nº529/2011.

Regulation nº 952/2012.

Decree 30.646 dated 14 September 2011. Changes Decree 30.328 dated 27 September 2010 that creates the Procedure for Expressing Interest in public-private partnership projects for both administrative and sponsored modalities.

Law 15.277 dated 28 December 2012. Authorizes the Executive Branch to contribute financially for the private partner in public-private partnership contracts in the State of Ceará.

FEDERAL DISTRICT

District Law 3792.

District Law 4828.

GOIÁS

Law 14.910 dated 11 August 2014. Covers the creation of Public-Private Partnership Program, the incorporation of the State of Goiás Partnership and Investment Corporation and other measures.

Decree 7.365 dated 9 June 2011. Covers the creation of Procedures for Expressing Interest (PMI) to guide the participation of the private initiative on the structuring of public-private partnership projects on both administrative and sponsored modalities, and for common and permission grant projects with the Executive's direct and indirect Public Administration.

MINAS GERAIS

Decree 46.100 dated 10 December 2012. Covers the State's Government portfolio of structuring programs, assigns the role of program manager, project manager, and process manager, and appoints public officials to exercise their respective roles.

Decree 46.001 dated 4 July 2012. Approves the state plan for public-private partnerships for the years of 2011 and 2012, with changes introduced by Decision #1 of the Public-Private Partnership Management Council.

Decree 44.565 dated 3 July 2007. Creates the Procedure for Expressing Interest in Public-Private Partnership Projects, for both administrative and sponsored modalities, and in common grant and permission projects.

Law 14.868 dated 16 December 2003. Covers the state program for public-private partnerships.

Law 14.869 dated 16 December 2003. Creates the State of Minas Gerais Public-Private Partnership Fund.

Decree 43.702 dated 16 December 2003. Deploys the Public-Private Partnership Management Council – CGPPP and other measures.

PARAÍBA

Law 8.684 dated 7 November 2008. Creates the public-private partnership program, determining specific rules for bidding and hiring in the State of Paraíba, and other measures.

PARANÁ

Decree 5.272 dated 16 July 2012. Regulates State Law 17.046 dated 11 January 2012 and other measures.

Decree 1.997 dated 13 July 2011. Creates the Public-Private Partnership Management Council under the State Secretariat of Planning and Overall Coordination.

Decree 5.272 dated 16 July 2012. Regulates State Law 17.046 dated 11 January 2012 and other measures.

Decree 6.823 dated 21 December 2013. Creates the Procedure for Expressing Interest in public-private partnership projects both in the administrative and sponsored modalities and on public service grants within the State Administration entities and agencies scope.

Decree 12.283 dated 29 September 2014. Regulates the Paraná Public-Private Partnership Guarantor Fund – FGP/PR, authorized by article 25 of State Law 17.046 dated 11 January 2012, and other measures.

Decree 1.575 dated 1 June 2015. Regulates article 6 of State Law 17.046 dated 11 January 2012 and other measures.

Law 17.046 dated 11 January 2012. Covers the rules for bidding and hiring Public-Private Partnership of Paraná (Paraná Parcerias).

Law 18.376 dated 15 December 2014. Changes the Law 17.046 dated 11 January 2012, that establishes rules for bidding and hiring Public-Private Partnership of Paraná (Paraná Parcerias) and voids Law 17.904 dated 2 January 2014.

TOCANTINS

Law 2.231 dated December 2009. Creates the State of Tocantins Public-Private Partnership Program – PPP and other measures.

Law 2.588 dated May 2012. Changes Law 2.231 dated 3 December 2009 that creates the State of Tocantins Public-Private Partnership Program – PPP.

SANTA CATARINA

Law 12.930 dated February 2004. Creates the regulatory framework for public-private partnership programs in the State of Santa Catarina, and other measures.

Law 1.932 dated June 2004. Regulates Law 12.930 dated 4 February 2004 that created the regulatory framework for public-private partnership programs in the State of Santa Catarina.

Law 13.335 dated February 2005. Authorizes the Executive branch to incorporate a company for Public-Private Partnership and grant projects.

Law 13.342 dated March 2005. Covers the Santa Catarina Company Development Program (Programa de Desenvolvimento da Empresa Catarinense, PRODEC) and the Fund for Support Santa Catarina Development (Fundo de Apoio ao Desenvolvimento Catarinense, FADESC).

Decree 962 dated May 2012. Covers the Procedure for Expressing Interest by the private initiative and other measures.

SÃO PAULO

Law 11.688 dated 19 May 2004. Creates the Public-Private Partnership Program.

Decree 48.867 dated August 2004. Regulates the Public-Private Partnership Program.

Decree 50.826 dated May 2006. Measures related to lien to real estate mentioned in Law 11.688.

Decree 51.126 dated September 2006. Measures related to lien to real estate mentioned in Law 11.688.

Decree 52.152 dated September 2007. Public-Private Partnership Contract Follow-up Committee.

Decree 57.289 dated August 2011. Details the submission, analysis and usage procedures for submission of proposals, studies and projects by the private initiative aiming for inclusion in the Public-Private Partnership Program.

Decree 61.371 dated 21 July 2015. Creates procedure for submission, analysis and usage procedures for submission of proposals, studies and projects by the private initiative or State Public Administration entity and other related measures.

* SOURCE: www.planejamento.gov.br / www.legislacao.pr.gov.br.

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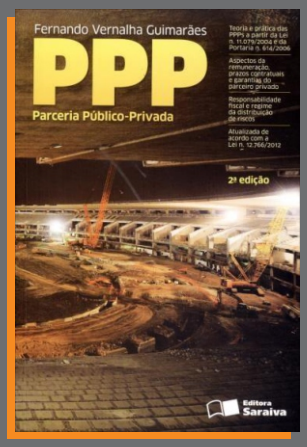

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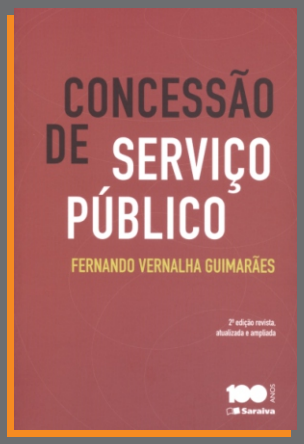

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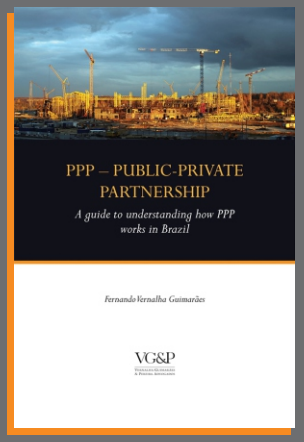

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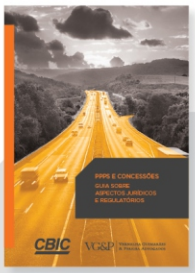

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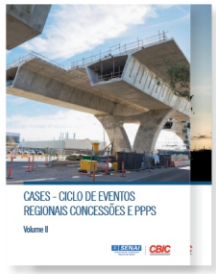

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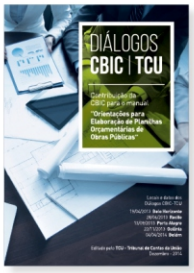

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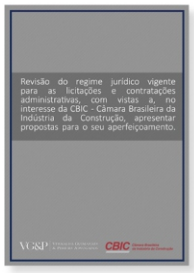

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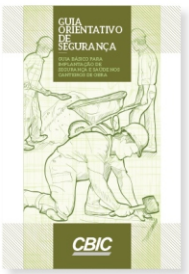

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