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# Agencies without the Rooseveltian State: legal regime of Regulatory Agencies in Brazil

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**Abstract:** *This article draws on a large survey regarding the appointment of heads of IRAs, which was carried out by the authors in 2016, to explain and illustrate the flawed attempt to implement an infrastructure regulation model based on independent regulatory agencies in Brazil.*

**Keywords:** Regulatory State – Independent Regulatory Agencies – political appointment – independence

## 1. Introduction

The creation of Independent Regulatory Agencies (IRA) in Brazil in the 1990s challenged the model of a unitary Executive Branch that had traditionally characterized the Brazilian State. Under the unitary model, the Executive Branch is conceived as one single hierarchical entity. The idea that entities of the Executive Branch could be conceived as “independent” shook the very foundations of the country’s legal system. It also entailed a political backlash that undermined not only the independence of these entities, but also their capacity to regulate.

This article explains and illustrates the flawed attempt to implement a model of infrastructure regulation based on the IRA model in Brazil. It does so by drawing in large part on an extensive survey carried out by the authors in 2016 titled “Nomeação de Dirigentes de Agências Reguladoras: Um Estudo Descritivo”, or *Appointment of Heads of Independent Regulatory Agencies: A Descriptive Study*. That study collected data to document and quantify problems concerning the process of appointment of IRA heads by the President and ratification by the Senate. It focused specifically on the six main federal infrastructure IRAs, namely the National Electricity Regulatory Agency (ANEEL), the National Telecommunications Agency (ANATEL), the National Civil Aviation Agency (ANAC), the National Water Transportation Agency (ANTAQ), the National Petroleum Agency (ANP), and the National Ground Transportation Agency (ANTT). The charts and graphs contained in the present article refer specifically to those six Agencies.

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Section 2 lays out the main tenets of the original plan alongside the historical context in which this plan was conceived. Section 3 uses examples to illustrate the way in which implementation deviated from the original plan. Section 4 provides a conclusion.

## **2. The original plan**

IRAs were created in Brazil in the 1990s to provide the legal framework necessary for a new economic policy. From the 1930s until the 1980s, infrastructure had been attributed to state-owned enterprises (SOEs), which typically operated as monopolies. But in the aftermath of the 1980s economic crisis that affected all of Latin America, including Brazil, these SOEs needed massive investments, but the government was essentially bankrupt. The solution was to implement a large-scale privatization program.

The challenge was how to attract private investment and, at the same time, to ensure that services and investments would be carried out while also considering public values such as universalization, lower prices for fares and tolls, equal access to public services, and continuous investment in quality. Influenced by the international experience, the envisaged solutions entailed the opening of monopolized markets for competition, withdrawing regulatory powers from SOEs, and privatizing most of these SOEs. Regulation of the resulting competitive infrastructure markets would then be carried out by IRAs.

The creation of the IRAs was a crucial step to generate trust on the part of private investors. The latter group typically fears the risk of government intervention and expropriation, a problem often framed as “political risk”. In particular, changes of power can create new political coalitions that bring about new regulatory philosophies and, more importantly, regulatory takings that are not fully compensated or are entirely uncompensated. This problem is particularly acute in infrastructure sectors, where sunk costs are very high and give rise to ample opportunity for governments to force changes upon the rules of the “game”. The prospect of uncompensated taking is even more acute in the case of foreign investors, who naturally are less willing to rely on local courts.

The problem of trust, however, goes both ways. The government also needs to be able to be confident that private investors will fulfill their part by employing adequate technology and rendering services that are acceptable and conducive to economic development. In theory, the risks of hold-out on the part of private investors is particularly great in situations where, as is commonly the case, private investors operate as *de facto* monopolists (and monopoly is the classic justification for government regulation). In addition, in the Brazilian political context, it would have been very difficult to politically justify the purely unregulated provision of infrastructure by private parties. Thus, the idea of regulation also found political resonance in Brazil.

The creation of IRAs was therefore the institutional compromise necessary to grease the wheels of cooperation between Government and private investors. On one hand, the independent Agencies would assuage the concerns of investors by shielding regulators from politics – thus the importance of such agencies being, indeed, “independent”. On the other hand, these Agencies would ideally be staffed with highly capable public servants whose actions would be technical rather than political.

Based on these premises, the laws that created each IRA established the basic organization structure, defined regulatory competences, and granted Agencies independence. The heads of the IRAs were granted tenure, so no IRA head could be dismissed at will by the President or by State Ministers. The Agency heads must be Brazilian citizens, have higher education, an unblemished reputation, and must be highly regarded within the field of the corresponding expertise. Moreover, IRAs were granted ample management autonomy, significant financial autonomy, and discretion to organize their services and their staffer's attributions. In addition, the laws governing each agency were structured around *standards*, so it would be up to the regulatory agency itself to effectively discipline the markets through specific rules. To reduce the risk of capture, each agency would be commanded by a collegiate, usually consisting of five members. All of this was consistent with international best practices.

Brazil's first IRA was the National Electricity Regulatory Agency (ANEEL), established in 1996 in tandem with the process of energy network unbundling and deregulation of generation and commercialization of electricity utilities. That was soon followed by the creation of the Brazilian Telecommunications Agency (ANATEL), again in tandem with the privatization of the Brazilian telecommunications SOEs. The General Telecommunication Law (Law No. 9.472/97) was a milestone for creating the IRAs in Brazil. It expressly granted ANATEL heads independence, characterized by "absence of hierarchical subordination, a fixed term and stability for its heads, and financial autonomy" (Article 8, Item 2). In addition, Article 9 determined that the Agency would act as an "independent administrative authority" and vowed to protect "the prerogatives needed for the proper exercise of [that] competence." Such legal provisions were reproduced in the other laws that later created other IRAs. As such, the Telecommunications Law would set the tone for a new regulatory system in Brazil. That was the original plan.

### **3. Independent Regulatory Agencies in action**

Most of the Brazilian IRAs were created during the two mandates of President Fernando Henrique Cardoso, between 1994 and 2002. But in the midst of an economic downturn, President Cardoso's candidate in 2002, José Serra, lost the election to Luis Inacio Lula da Silva, more often known simply as "Lula", from the opposition Workers Party (PT). The Workers Party had been historically linked to unions of disenfranchised workers of privatized SOEs, and its opposition to privatizations meant that it had historically rejected the demise of the unitary model of the Executive Branch and the ascendance of the IRAs model.

Lula's victory and the ascension of PT to power reversed the trend of Brazil moving towards a more market-based economy. It also thwarted the original plan concerning the IRAs' role. An important milestone happened in 2003, when President Lula, soon after taking office, created an inter-ministry study group whose goal was to reassess the model of IRAs. The report supported reducing the independency of these Agencies – even if, to minimize political backlash, everything was sugar-coated in a language that saw changes as mere "ratifications" of the independent agency model.

This report was structured around six axes. Accordingly, the Government should seek to: (i) adjust the level of autonomy of the IRAs in relation to the Ministries; (ii) redefine the range activities performed by IRAs, notably concerning planning, and granting of

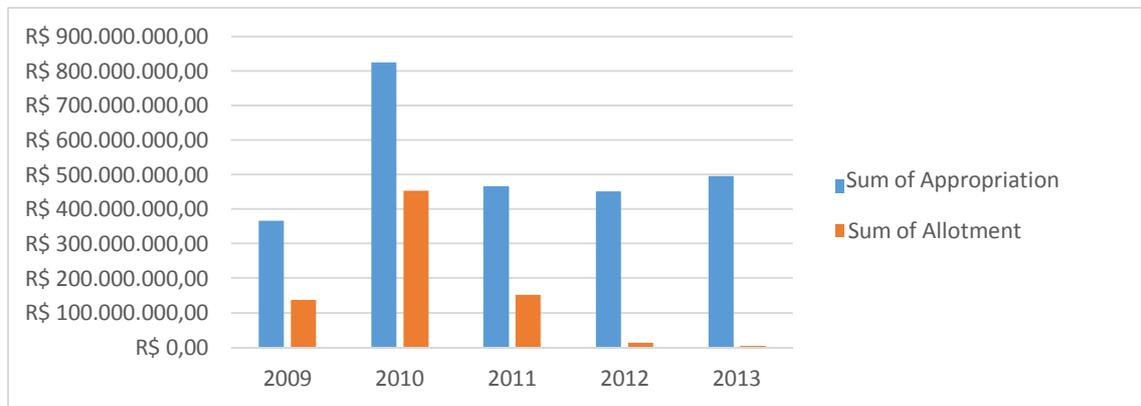
concessions and permissions; (iii) strengthen Ministries; (iv) enhance the effectiveness of the IRAs in protecting the interests of consumers (a nominal but inconsequential assignment of power to these Agencies);(v) reshuffle staffing at IRAs; and (vi) create mechanisms for accountability on the part of the agencies vis-à-vis Congress.

Some of the ideas delineated under this report ultimately crystallized into concrete measures that unequivocally reduced the independence of the Brazilian federal IRAs, the most relevant of which was the following:

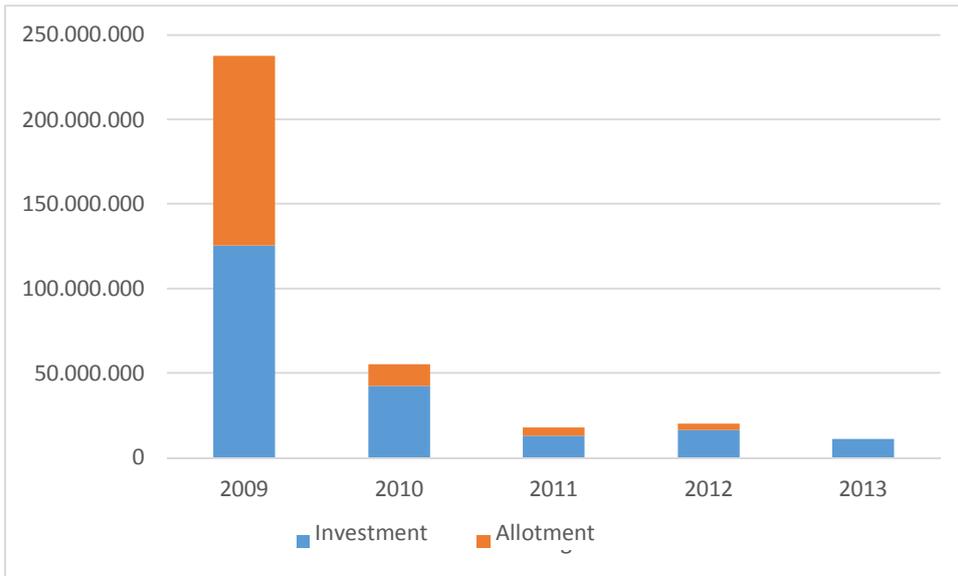
*a) Budgetary Allotment*

The Government imposed severe restrictions on the funding of federal IRAs. This was done by means of a bureaucratic process called “contingenciamento”, that is, budgetary allotments. The federal budget consists of legislation that directs payment out of Government funds in specified conditions or for specific purposes. A budgetary appropriation arises where certain funds are allocated to specific ends in that legislation. A budgetary allotment occurs when part of appropriated funds is withheld. By resorting to budgetary allotments for funds marked for appropriation at IRAs – often on the questionable grounds of lack of financial resources – the Executive and the Legislative branches could effectively reduce their independence.

To be sure, the problem of budgetary allotments is not exclusively a Brazilian one, but rather the plight of every “independent” Agency worldwide. The extent of the use of budgetary allotments in the past decade in Brazil was, however, quite strong and it served as a powerful weapon employed to reduce the IRAs’ independence. Charts 1 and 2 illustrate with numbers the extent of budgetary allotments at the National Ground Transportation Agency (ANTT).



**Chart 1.** Budgetary appropriation and allotment at ANTT.

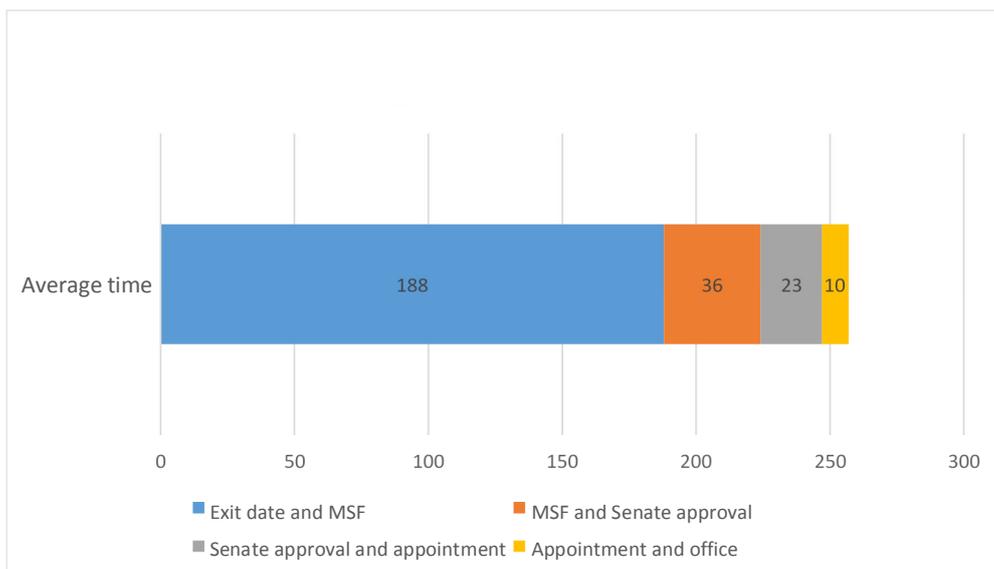


**Chart2.** Investment and budgetary allotment at ANTT.

*b) Deadlocks and delays in the appointment of IRA heads*

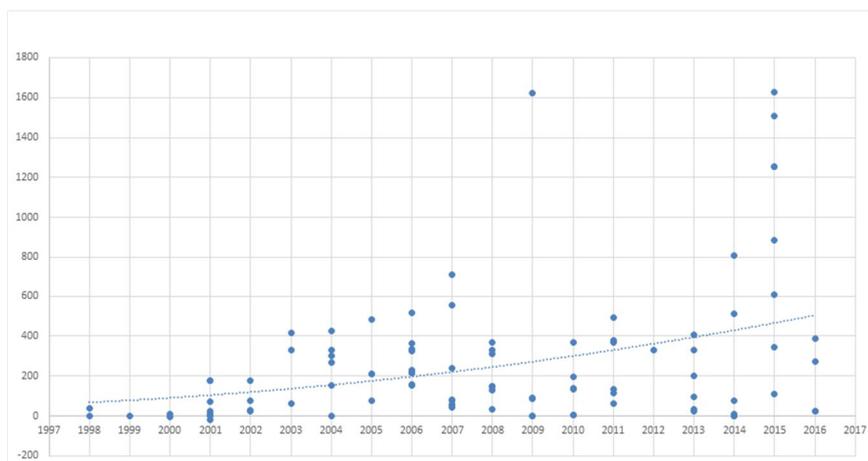
Independent Regulatory Agencies are ruled by a collegiate body consisting of heads appointed by the President, with the consent of the federal Senate. This process can be delayed due to political deadlock, because the Senate can use the threat of non-ratification of appointees as a bargaining chip in negotiations with the Executive Branch. At the same time, the Executive can also withhold appointments as a means to effectively incapacitate Agencies in reaching decisions. These problems have been commonplace in Brazil for the last 15 years.

When an IRA head leaves office, a new appointment process starts. Ideally, the President will soon send a message to the Federal Senate (MSF) with the name of the nominee. This process can, however, be lengthy; and this is certainly the case in Brazil. Chart 3 shows that in Brazil this normally takes approximately six months.



**Chart3.** Appointment process of leaders of Regulatory Agencies per stage.

One of the implications of these delays in sending the name of appointee candidates to the Senate is that roles in the collegiate often remain vacant. Chart 4 shows that after the year 2003, vacancies have progressively increased. It also shows that, after 2014, the average number of days of vacancies skyrocketed, probably as a consequence of the political weakening of then- President Dilma Rousseff, also from the Workers Party, just prior to the conclusion of her impeachment process in 2016.



**Chart 4.** Average vacancy time the position remains vacant at the Regulatory Agencies.

During the past decade, almost every federal IRA in Brazil suffered from the problem of vacancies. A complete appointment takes from two months to one year (353 days on average) – even if to be fair the timeframe was shorter for the position of President of the IRA, which takes from about two to six months (an average of 152 days). Chart 5 also shows that some agencies had more serious problems with vacancies than others.

Sum of vacancy days

**Chart 5.** Total of position vacancy days per Regulatory Agency.

**Note:** ANAC is the National Civil Aviation Agency; ANATEL is the National Agency of Telecommunications; ANEEL is the National Electric Energy Regulatory Agency; ANP is the National Petroleum Agency; ANTAQ is the National Water Transportation Agency; and ANTT is the National Ground Transportation Agency.

Vacancies can, and often did, cause paralysis of IRAs. Consider that the deliberation quorum in most of the federal IRAs is the absolute majority within a collegiate of five members, so three vacancies mean that the Agency would be at a standstill. In fact, except for the National Telecommunications Agency (ANATEL), all of the other Infrastructure IRAs have at some point experienced episodes of paralysis in decision-making. The most dramatic case is that of the ANTT, where vacancies result in the agency's paralysis for 5 months and 12 days, from March and September 2015. The ANTT had already experienced other episodes of paralysis of decisions.

*c) Appointment of interim IRA heads by State Ministers*

The solution sometimes offered for this paralysis problem was to have the State Minister appoint the IRA heads, which was obviously a subversion of the idea of agency independence. Around 2010, the Federal Government Accountability Office (*Tribunal de Contas da União*) started to flag the problem of vacancies at the ANTT. In response, in 2012, President Dilma Rousseff issued an Order allowing the Minister of Transportation to appoint a staff member of the ANTT until a regular appointment process was fully completed. A similar solution was later implemented by ANTAQ, in which case the appointment was entrusted to the Chief Office of Ports of the Ministry of Transportation (*Secretaria de Portos*).

*d) Characteristics of the heads of the Independent Regulatory Agencies*

The individual profile of the heads of IRAs not only affects the quality of regulation, but it can also influence their levels of independence.

The first aspect to be highlighted is that many IRA heads came from other Offices within the federal Government – a practice sometimes referred to as the “public revolving door”. As depicted in Chart 6, IRA heads often came from Ministries (22%), SOEs (12%), and other state-owned Agencies and entities (15%). In part, this process is driven by a desire for additional earnings by public servants, who typically add the IRA salary to their original paychecks. Perhaps, the *public revolving door* also reflects the cultural notion that the Executive Branch is unitary, regardless of what the law says. Crucially, during the past decade the *public revolving door* reflected the attempt of the President and its Ministers to curb the IRAs’ independence.

<b>Origin of the nominees for leading positions at selected federal regulatory agencies</b>	
<b>Regulatory Agencies</b>	<b>24%</b>
<b>Ministries</b>	<b>22%</b>
<b>Other State-owned agencies and entities</b>	<b>15%</b>
<b>State-owned company</b>	<b>12%</b>
<b>Academia</b>	<b>10%</b>
<b>Private sector</b>	<b>6%</b>
<b>Senate</b>	<b>6%</b>
<b>Others</b>	<b>3%</b>

*Chart 6. Origin of the nominees for leading positions at Regulatory Agencies.*

*Note:* The "other State-owned agencies and entities" category includes State-owned agencies and entities that are not listed, such as the Federal Agency of

Applied Research (Instituto de Pesquisa Econômica Aplicada – IPEA), Municipal Legislative Branch and State-owned agencies. The "others" category includes other non-State-owned companies that do not fit within the "private sector" category, and they are: law business (2%) and international association (1%).

As can be seen, this chart also shows that 24% of the IRA heads had previously been staffed as public servants. If on one hand this practice can reduce capture by the private sector, on the other hand it can enhance the prospects of capture by the President and the State Ministers. The reason, simply put, is that the safest way for a staff member to secure a Presidential appointment is never to oppose her.

The table also points out to the low incidence of leaders coming from the private sector. A possible explanation is that leadership positions in federal IRAs are only financially attractive for public servants, because by combining paychecks their overall compensation averages approximately R\$ 25,800.00, whereas without the combination of paychecks total remuneration is of only R\$ 14,408.37. Indeed, 58% of IRA heads are also regular public servants. At the same time, the prospects of a future profitable career in the private sector should serve, and certainly does serve, as an enticement for individuals coming from the private sector to seek a leadership position; being politically connected is useful in any country, and Brazil is no exception. As such, the explanation for the prevalence of public servants as IRA heads is most probably found in the political options of the Presidency than through the will of individuals working in the private sector.

This explanation is further corroborated by the fact most IRA heads have previously held other “at will” appointments in the public sector. In fact, only 10% of them have never held an at-will appointment while 80% have had 1 to 10 such appointments before becoming an IRA head. Again, this does not necessarily mean that the IRA heads are incapable, because many of these leaders are part of the elite of public servants, who are highly qualified, possess strong technical qualifications and hold a well-deserved reputation of being committed to honest behavior. Yet, their degree of independence vis-à-vis the President is hardly the same as that of a person that comes from the private industry.

#### *e) The improper hierarchical appeal*

Improper hierarchical appeal is the name assigned to an appeal to the Minister against a decision by an Agency. The adjective “improper” indicates its exceptional nature, because ordinarily (i.e. “properly”) decisions by independent bodies such as IRAs should not be appealable to State Ministers. To understand how “improper” appeals curb independency, consider the following situation.

In 2005, the National Water Transportation Agency (ANTAQ) decided that a certain fee charged by port operators at Porto de Salvador was abusive. The local company, interested in continuing charging for said fee, appealed to the collegiate of ANTAQ, requesting that the matter be submitted to a review by the Ministry of Transportation. The request was denied on the grounds that only the Judiciary was in a position to review the IRA’s decision. The company did not accept such a decision. Relying on questionable constitutional grounds, it then decided to file a hierarchical appeal with the Ministry of Transport. To the surprise of many, the Ministry of Transportation decided not only to hear such an appeal, but also to overrule the decision of the ANTAQ, seeing the charging of the fee in question as illegal.

A question was then raised as to whether the Ministry of Transportation had overstepped the mandate of ANTAQ. In Brazil, conflicts of this sort are decided upon by the Attorney General. The Attorney General decided in favor of the ANTAQ in this case, – that is, the fee was considered legal. However, at the same time, it upheld a doctrine that a State Minister can control the decisions of regulatory agencies in three extremely broad circumstances: (i) where the IRA exceeds the limits of its legal competence; (ii) when the agency's decisions contradict public policy as defined by the President or by State Ministries; or (iii) if the IRA's decision is illegal.

Items (ii) and (iii) allow a great deal of leeway for parties to question decisions of IRAs before State Ministers, yet the laws that created the IRAs contained a much narrower scope for State Ministers to question the IRAs' decisions. As a result, IRAs have been weakened by a new system of appeals.

#### *f) The management contract*

A final mechanism used to curtail the model of independent agencies was the creation of the so-called *management contract* (“contrato de gestão”). This mechanism was instituted by means of a constitutional amendment in 1998 and it aimed at facilitating the coordination among different bodies within the Executive Branch. Accordingly, Ministries and IRAs were authorized to sign an agreement that would render public the exact scope for the conduct of each body. The original idea was that a clearer definition of scope would highlight the autonomy of agencies and ministers, thus reducing uncertainty and red tape.

In this spirit, the laws determining the creation of several IRAs mandated that they enter into management agreements with the related State Ministry. This is the case with for instance, ANEEL, the National Health Surveillance Agency (ANVISA), National Complementary Health Agency (ANS), and the National Water Agency (ANA).

With time, however, management contracts started to increasingly be used as a means whereby State Ministers would curb the IRAs' independence. Contracts grew in number and scope, and increasingly started to establish concrete goals that went far beyond the original standards that would guide the IRAs' activities. At times, the Agency's budgetary endowment was conditioned on contractual performance. These contracts, together with the other five mechanisms previously mentioned, meant that the original plan would be thwarted and independence would remain a mirage. The unitary model would resist – if not in name, at least in substance.

#### **Section 4 – Conclusion**

Devising a plan through legislation is one matter; implementing it is quite another. Like any other legislative initiative that can be meaningfully considered “radical”, the creation of the Independent Regulatory Agencies in Brazil evolved in a way that diverged from the original plan. In fact, perhaps the defining feature of Brazilian IRAs is that their legal regime is still unclear. What could be called a *full institutionalization*, in the sense of having a clear and predictable legal set of rules, is still lacking. And as it seems, consolidation will take time.