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# Brazilian power buyers flock to 'free' market

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Private power purchase agreements, increasingly prevalent in developed countries and some developing nations such as Mexico, are on the rise in Brazil.

Brazilian power purchasers are turning to the 'free' market of the Ambiente de Contratação Livre (ACL) in search of better pricing. ACL is a market for buying and selling electricity via freely negotiated bilateral contracts, rather than via set-price auctions run by power regulator Aneel.

While the regulated environment still accounts for the vast majority of power purchases, by mid-2018 ACL facilitated the sale of around 30% of power consumed in the country (18,046MW). Some observers believe this could invert in the next decade of so, with ACL representing 70% of the market.

There are however specifics to the Brazilian market which make private PPAs challenging for financiers and developers.

**Brazil-specific challenges**

**Prices –** Brazilian power regulator Aneel approved on 13 November new rules for pricing the electricity sold on the free market. The move is seen as the removal of one important obstacle to the growth of the ACL market. Today, prices are set on a weekly basis and, starting in January 2020, they will be calculated on an hourly basis, better reflecting demand fluctuations.

**Grid connection –** Several people close to this market have told *IJGlobal* that many power producers actually try to participate on the government-led auctions with a small percentage of the project, selling the majority of power on the free market. The main goal is to overcome the uncertainty of having a connection to the grid, because auction-winners receive a priority to connect. By having both auction-won power and private PPAs, the sponsor guarantees transmission capacity and better prices at the same time.

**Tenor –** Banks looking into financing projects in Brazil find it especially difficult to support assets with shorter-term contracts. The ACL market on average offers contracts of four to five years, a huge contrast to Aneel's contracts, which vary from 20 to 30 years depending on the electricity source used.

**Offtaker and sponsor risk –** Brazil does not have an established pure project finance industry as internationally known. Most financing transactions require guarantees, which can be provided by multilaterals or, as is more common, corporate guarantees are put in place - even if the loan is on the project level. It means that, in a project meant to sell power on the free market, banks need to take into consideration both the risk profile of project and underlying sponsor, the latter being a risk usually overlooked for projects contracted at Aneel's auctions. This has a direct impact on financing costs.

**Understand the regulated vs free market**

Brazil introduced power market reforms in 2004. Since then, the government – through the electricity chamber of commercialization (CCEE) and Aneel – has been organizing yearly electricity auctions to power a pool of distributors. This became a very stable and internationally well-accepted model, which gave renewables the chance to grow in percentage of the total electricity mix and compete equally with other power sources.

With a stable cash flow from the long-term PPAs, international companies became comfortable with developing projects in the country and started participating in the auctions. The auctions have transformed the Brazilian power mix.

In the early 2000s, hydropower plants accounted for approximately 95% of the electricity produced in the country. Now, it is around 60%, with gas-fired plants and renewables, especially wind farms, taking up a larger chunk of the mix.

In recent years, electricity prices have drastically increased in the country, especially after 2015, when the government has ended some subsidies provided three years earlier.

From 2008 to 2017, the average local power prices escalated 85%, becoming one of the most expensive tariffs in the world, due to taxes, subsidies, auctions fees, delays on new plants approvals and the need to compensate droughts with more expensive sources. One study shows that power prices in Brazil are more than 125% above those paid in the United States.

Therefore, large consumers ended up migrating to the ACL market to reduce costs. Associations that represent power producers in the country estimate that the so-called free market will became a majority, reaching as much as 70% of total power produced by 2030.

One transaction that highlights this trend is the Companhia Energética de Minas Gerais (Cemig) auctions, the first of its kind in Brazil. The company (50% owned by the state of Mines Gerais) acquired a total capacity of 583MW in two different auctions that selected private contracts directly with producers from solar and wind plants, to replace the hydropower generation it lost due to the concessions with private players. Cemig's main goal is to attend the demand on the free market.

Some of the largest consumers on the free market are aluminium producer Albras, Braskem, ArcelorMittal, Vale and CSN.

**The future**

With a new government recently elected in Brazil, specialists expect the share of financing going to the capital markets to grow. President-elect Jair Bolsonaro has demonstrated his intention in cutting public spending, which will probably reduce BNDES and BNB participation on financings.

Bankers have told *IJGlobal* that there is appetite for lending to projects on the free market, especially with first-class offtakers such as the mining company Vale.

It seems to be a consensus that the free market will be the future of power commercialization in Brazil, with all players trying to understand its own bargain capacity. And the new government will influence that with policies for the power market and for the development banks that dominate financing in the country.