

Turnaround/Insolvency Issues in Electric Sector: International Experience and Its Lessons for Brazil

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Policy Perspective

Two Fundamental Approaches to Insolvency in Energy Sector

1. Governmental Approach

- Nationalization
- Financial Package (Loans or Grants)
- Direct Subsidies

2. Commercial Approach

- Management Changes
- Bankruptcy
- Regulation

Transition

Will Brazil Move from Governmental Approach to Commercial Approach?

What Instructive Lessons Can Be Learned from International Experience?

Two Separate Contexts

- Competitive Enterprises (e.g., Generators, Suppliers)
- Fully Regulated Enterprises (e.g., Distribution or Transmission Monopolies)

Interests to Be Balanced in Energy Company Insolvency

■ Competitive Context

Creditors vs. Shareholders

- Two Competing Commercial Interests + Public Interest Considerations

■ Fully Regulated/Monopoly Context

Creditors vs. Shareholders vs. Consumers

- Two Competing Commercial Interests + Consumer Interests + Public Interest Considerations

Competitive Context

Creditors and Shareholders: Common Interests/Conflicting Claims and Priorities

- Internalized Economic/Financial Perspective
 - Maximizing Debt Recovery/Value Retention
 - Control of and/or Access to Revenue Stream
 - Maximizing Revenue Stream
 - Cost/Liability Minimization

Competitive Context

Public Interest Considerations

■ For Generators

1. Must Run Units
2. Capacity Planning/Reliability Obligations
3. Plant Retirement/Environmental Considerations
4. Efficient Deployment of Society's Assets (Externalized Perspective)
5. Maintenance of Competition

Competitive Context

Public Interest Considerations

■ For Suppliers

1. Customer Service Obligations
2. Default Supply/Arbitrage Issues
3. Consumer Protection (e.g., Fraud, Default)
4. Maintenance of Competition

Competitive Context

Corporate Governance/Management Considerations

- Management Subject to Shareholder Control
- Debt Covenants/Creditor Requirements
- Judicial Intervention

Monopoly/Fully Regulated Context

■ Shareholder/Creditor/Public Interests

- Same Interests As in Competitive Context
- Same Issues As in Competitive Context

*****PLUS*****

■ Consumer Interests

- Preservation of Consumer Paid Value for Consumers
- Reliable Sustainable Quality Service
- Reasonable Prices? Avoiding Monopoly Rents
- Capital Structure (Debt-Equity Ratio)
- Meaningful, Balanced and Appropriate Incentives

Monopoly/Fully Regulated Context

■ Role of Regulator

■ More Externalized Perspective

- Balancing Investor (Shareholder and Creditor) Interest and Consumer Interest
- Focus on Protection of Consumer Interest
- Protect Public Interest

Monopoly/Fully Regulated Context

■ Areas for Potential Conflict

■ Tariffs

- Who Sets Them and for What Objectives?
- Creditors and Shareholders Seek Maximization of Revenues
- Consumers Want Protection Against Monopoly Power

■ Contractual Issues

- Debt Covenants
- Achieving Compliance Through Performance or Tariff Manipulation

Monopoly/Fully Regulated Context

■ Areas for Potential Conflict, continued

■ Accounting Issues

- Financial Accounting May Differ from Regulatory Accounting
- Cost Deferrals vs. Recovery vs. Normalization

■ Service Quality

- Creditors and Shareholders Will Seek to Minimize Costs
- Consumers Want Quality Service (i.e., Maintenance and Investment)

Monopoly/Fully Regulated Context

■ Areas for Potential Conflict, continued

■ Capital Structure

- Insolvency Will Reduce Equity Component
- Regulators May Want Higher Equity Component

■ Management Issues

- Creditors May Want More Control of Management
- Regulators May Impose Management/Financial Restrictions
- Regulators May Appoint Receivers or Intervenors

Monopoly/Fully Regulated Context

- Areas for Potential Conflict, continued
 - Jurisdictional Issues
 - Regulators vs. Bankruptcy Courts