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BEHIND THE NEWS: Does Brazil's Electricity Sector Modernization Have A Chance?

Yes, says a consultant, if the government reduces its tendency toward over-regulation

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Rachel Andalaft, a founding partner of REA Consult, a German/Brazilian-based management and consulting firm focused on sustainable investments into renewable energy and sustainable industries, believes that while exciting reforms are taking place in Brazil's electricity sector, the talk of modernization is not new. In this email interview, she expanded on why she thinks recent events have created a momentum convincing many in the sector that change is coming.

Brasil Energy: Do you expect the reforms to make it easier for foreign investors to take on the Brazilian energy market?

Andalaft: The Brazilian energy market is certainly moving in a desirable direction. The master plan is to reduce government's over-regulating role and to develop an efficient, liberalized market in which agents can answer to price signals with the right cost allocation, maximizing uses and benefits. I expect a much more business-friendly market design, but Brazil will not lose its complexity.

Electricity sector reform in Brazil is a never-ending story. What's different about the recent efforts?

It's true, Brazil's first electricity sector reform took place in 1995, resulting in the emergence of the unregulated consumer. Seven reform attempts later, in 2016, an initiative called Public Hearing 33 (PH 33) raised a list of urgent matters to be addressed, but fell short of any decisive execution.

Today, the reform plan resumes the previous efforts but elaborates greatly on the sector design, bearing tremendous potential and enjoying a much more favorable momentum than we have seen before.

How is the government approaching energy reform?

It's the case of two legal instruments being appraised by the legislative body (legislative bill 1.917 in the lower house and legislative bill 232 in the Senate). These bills target structural improvements, such as market design and liberalization. The task force set up by the Ministry of Mines and Energy (MME) is cooperating closely with local players as well as with international peers and spent the last months focusing on a broad range of issues such as hourly prices, supply criteria, market liberalization, and the split between guaranteed yield and energy, among other things.

How long is this legislative process expected to take?

The aim is to proceed with structural changes, even if they require substantial time for implementation. Brazil's long-dated, patchwork regulation often brings more unexpected consequences than it relieves. The squareness of the circle lays in defining measures to accelerate the sector expansion, while circumvented in a complex regulatory framework designed for long-term, centralized contracts.

What is the major challenge for grid sustainability in Brazil?

The key challenge lies in the economic rationale behind transmission charges and subsidies. In 2017 alone, transmission costs were responsible for 50% of energy expenses. A significant part of this revenue is allocated to the Energy Development Budget (CDE), a mechanism created in 2002 to channel funds into all sorts of public policies and subsidies. The return on grid sustainability falls too short.

Is supply expansion possible in the current system, what must change?

The Brazilian market design is outdated, to say the least. Today, the energy matrix is less hydropower dependent than in the past. Impacted by climate change, the system was caught short-handed to manage flexibility and reliability. Moreover, in the last years, the number of unregulated consumers experienced a steady increase within an essentially overregulated market. Unregulated consumers make up for one-third of the country's demand. Trapped in an obsolete model, captive consumers bear much of the electric system's expansion costs.

Segregation between guaranteed yield and the energy production is one of the bets to, within the present infrastructure, better share the costs. However, it requires overcoming regulatory limitations, since guaranteed yield not only defines each plant's contribution to the electric system but also binds its revenue in an over-centralized balancing mechanism.

What signs do you see for market liberalization as part of this reform?

The Mines and Energy Ministry (MME) plans to accelerate the market liberalization by phasing down the current 2.5 MW migration limits by 0.5 MW every six months. The new buyers would be entitled to freely negotiate PPAs and choose the sources for their electricity demand. With increasingly more customers being allowed to choose their energy sources and providers, combined with the emergence of hourly prices, retail traders will be the new face in the market.

Will liberalization strategies impact distributed generation goals in Brazil?

Brazil became a worldwide reference for net metering and distributed generation with legislative bill 482/2012. Now, this bill is under revision by the Brazilian National Electric Energy Agency (ANEEL). ANEEL is facing heavy criticism, and a great part of this is very well founded. Especially, if you consider the economic barriers the solar supply chain bears in Brazil. This is precisely the fact why a sustainable answer to the distributed energy doesn't lie in perpetuating subsidies in the core of its business model, but rather by fostering an open and competitive market that will allow Brazil to benefit from the international marketplace.

