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PLENARY MEETING

Brazil

STRUCTURAL REFORM OF THE TELECOM SECTOR - THE BRAZILIAN EXPERIENCE

1 Brief background¹

Although the beginning of telephony in Brazil goes back to the last century, shortly after its invention by Alexander Graham Bell (who was granted a Brazilian patent in 1883), it was only in the second half of this century that a law was passed in Brazil to specifically deal with the telecom sector: Law No. 4.117 of 27 August 1962. At that time Federal, State and municipal agencies exploited telecom services according to the ambience on each level either directly or by means of a corresponding concession. The right to set corresponding tariffs was also decentralized. There were about 1 200 telephone companies in the country, the majority being medium or small enterprises, with no coordination among them nor any commitment to common guidelines for system development and integration. This was a serious obstacle to sector development.

The above-mentioned Law No. 4.117, known as the Brazilian Telecommunications Code, contained the following main points:

- creation of a National Telecom System, aimed at ensuring provision of integrated telecom services;
- placing interstate telegraph, radiocommunication and telephony under Federal jurisdiction;

¹ Most of this chapter was taken from the Exposition of Motives that accompanied the project for the General Law of Telecommunications, submitted by the Administration to the National Congress in December 1996, the editing of which was coordinated by the author, along with the Executive Summary of the document "General directives for the opening up of the telecom market" published by the Ministry of Communications in 1997, the preparation of which was also coordinated by the author.

- establishment of the National Telecom Council (CONTEL)² with the power to approve telephone system specifications, as well as set criteria for tariffs throughout the country;
- granting competence to the Federal Government to directly exploit trunk lines of the National Telecom System;
- authorizing the Executive Branch to set in place a public company to exploit commercially the trunk lines of the National Telecom System (this company would become EMBRATEL);
- establishment of the National Telecom Fund - FNT - consisting basically of funds from charging an additional tariff of up to 30% of the public telecom services tariffs, in order to finance EMBRATEL activities; and
- definition of the relationship between the granting agency and the concessionary in the field of radio broadcasting.

EMBRATEL (Brazilian Telecom Company) was founded in 1965 and, with support from the FNT, undertook the immense task of interconnecting all of the state capitals and major cities of the country. In 1966, CONTEL regulated the then usual practice regarding financial participation by those requesting a telephone line, thus transforming it into an important instrument of support for the expansion of telephone services in Brazil: namely, self-financing³.

The problem of fragmentation of the power to grant concessions, however, was only solved on 2 February 1967 by Decree-Law No. 162, that concentrated this power in the hands of the Federal Government. This arrangement was further consolidated by the Constitution of 1967 and has been maintained until now. However, the Constitution of 1988 went even further and ordered that public telecom services could only be exploited by the Federal Government, either directly or by granting concessions to companies under State control.

On 25 February 1967, the Brazilian Government promulgated Decree-Law No. 200 which, among other measures, created the Ministry of Communications to which CONTEL and EMBRATEL were soon subordinated.

The measures taken by the Code led to a significant improvement in long distance and international services, but this did not happen in the case of local service. So, in 1971 the Government pondered the founding of a public entity to plan and coordinate national telecommunications, to obtain the necessary funding for implementing telecom service systems and to control the use of such funds through participation as majority shareholder in the companies charged with providing these services. With this arose the idea of creating TELEBRÁS (Brazilian Telecommunications S/A) which became a reality with the sanctioning of Law No. 5.792 of 11 July 1972.

² Thus, CONTEL was the first telecom regulatory agency in Brazil, and had as its executive arm DENTEL - National Telecom Department. CONTEL was deactivated in the 1970s and DENTEL followed in the 1990s.

³ The sum of the financial participation by the so-called *promissory subscribers* was initially equal to the cost of the investment needed for setting up and activating its terminal, and was the equivalent of \$US 3 000 in the 1980s. As a counterpart to this payment the subscribers received shares in the operating companies or in TELEBRÁS. In 1994 the value of self-financing was the equivalent of \$US 1 200. This mechanism was officially terminated in 1997.

This law, besides authorizing the establishment of TELEBRÁS, which occurred on 9 November of that same year, also made FNT funds available to it and authorized the transformation of EMBRATEL into a mixed economy company and a TELEBRÁS subsidiary. The law placed TELEBRÁS under the Ministry of Communications.

Shortly after its founding, TELEBRÁS started the process of acquiring and absorbing telephone operating companies throughout Brazil, with the intent of consolidating them into State companies. At that time there were more than 900 independent operating companies in Brazil, with a total of about 2 million telephones. In 1974, with Decree-Law No. 74.379, TELEBRÁS was designated as the "general concessionary" for exploiting public telecom services throughout the entire country.

Today, public telecom services are provided by the TELEBRÁS System (which controls approximately 90% of the total number of telephones) and by four independent firms, three of which are State companies and one of which is privately owned. The TELEBRÁS System is comprised of the TELEBRÁS holding company controlled by the Federal Government; a national and international long distance carrier (EMBRATEL); 27 local and State operating companies dealing with fixed telephony; and, since the end of January 1998, 26 local or State companies that are providing mobile cellular service, resulting from the breakup of the fixed telephony companies.

The National Telecom Fund (FNT) was eliminated at the beginning of the 1980s, and thus TELEBRÁS lost an important source of funding to underwrite the expansion of the system. This fact, together with mistakes in tariff policy and managerial problems, meant a growth in the plant that was significantly lower than the demand, bringing about a situation in which the telecom system became an obstacle to the very development of the country.

This led the present Administration to decide on implementing a profound change in the sector, even during an election campaign. The transformation process was undertaken at the beginning of the present Administration in 1995, in order to create an ambience more favourable to sustained growth of the sector and a more effective placement of Brazil among the group of nations that must lead the world through the process of integrating society by means of communication, as required by the new information age.

2 Project development

The first step in the reform was the submission to the Congress of a proposed amendment to the Constitution calling for an alteration of the article that determined the telecom services considered as public (which included practically all communication services available to the general public) could only be provided directly by the Federal Government or, by licence⁴ granted by the government to companies under control of the State as majority shareholder. This proposal was sent to the Congress in January 1995 and, in order to provide a basis for discussion by the Legislature, the Ministry of Communications published a document in April entitled "Telecommunications and the Future of Brazil", which was distributed to the legislators and provided basic input for an understanding of the context of telecommunications throughout the world and the importance of setting in place a new competitive posture to stimulate private investment in the sector, in order to adequately meet the demand and boost the economic and social development of the country.

⁴ A licence could be a concession, permission or authorization, depending on provisions contained in the regulation.

This document laid down the central ideas of the project for the institutional restructuring of the telecom sector: namely, transparency, the creation of a fair competitive environment, and privatization.

The proposal was approved by the Congress in August 1995⁵ and the new constitutional text provided that:

- a) the competence of the National Congress to legislate regarding telecommunications would continue;
- b) it would continue to be within the competence of the Federal Government to exploit telecom services, directly or by means of concessions, permissions or authorizations;
- c) the new juridical scheme for telecommunications would have to be defined by an ordinary law, with provisions regarding the organization of services, the creation of a regulatory agency and other institutional aspects.

Parallel to the discussions in the Congress, the Ministry of Communications prepared two documents that were published in September 1995 and designated as REST-1 and REST-2 (for Structural Reform of the Telecommunications Sector): the former containing a workplan, and the latter, premises and general considerations. These documents reinforced the central ideas as put forth in the text published in April, detailing and emphasizing the attention to be given to the rights of minority shareholders during the process.

These documents defined, therefore, the foundation for all of the work that would come later and this was effectively followed. The single exception was that which was denominated as minimum regulation that detailed some points of the regulation process as based on the law that was still in force⁶, for the purpose of opening up some services to competition in areas where the demand was greatest and the provision of which was in the interests of private companies: namely, mobile cellular service, telecom service via satellite, data communication services and value-added services in general. As a precautionary measure, with the objective of reducing the risks of juridical problems relating to this liberalizing, it was decided that instead of minimum regulation, a specific law should be submitted to the National Congress dealing with this issue.

Such a proposal was submitted to the Congress at the end of November 1995 and the bill was approved in July 1996, becoming Law No. 9.295 of 19 July, and becoming known as the specific law or minimum law⁷. Its passage prompted the publication of a presidential directive dealing with its regulation, as well as a norm from the Ministry of Communications detailing all the necessary aspects for the implementation of a competitive environment in the sector⁸.

⁵ Approval of a Constitutional amendment requires the vote to be made in two sequential sessions in each of the two Houses of Congress, with a quorum of 3/5 of the votes being present in each of the Houses.

⁶ At the time, Law No. 4.117 dating from 1962.

⁷ The name specific law was used because it deals only with some specific aspects of the telecom sector and was not the general law provided for in the new text of the Constitution; the name minimum law is derived from the concept of minimum regulation as provided for in the REST-1 and REST-2 documents.

⁸ The norm is called NGT-20 (NGT being the abbreviation for *General Telecommunications Norm*). This norm defines the institution of a regional dual pole for the provision of service - bands A and B - as well as the division of the country into ten areas for implementing the norm.

Concomitant with these measures, the Ministry of Communications was at work on a new model for the Brazilian telecom sector, aligned with the new Constitutional amendment and based on the directives established in the above-mentioned REST documents. The proposal for the new law was submitted to Congress in December 1996. Following intense debates, the new General Telecommunications Law was enacted and signed by the President on 16 July 1997 as Law No. 9.472.

This was done to achieve five central objectives:

- I) strengthen the regulatory role of the State and eliminate its role as an entrepreneur;
- II) increase and improve provision of telecom services;
- III) in a competitive environment, create opportunities that attract investments and technological and industrial development;
- IV) provide conditions so that sector development will be in harmony with the country's goals for social development;
- V) maximize the sale value of State owned telecom companies without prejudicing the foregoing objectives.

The general law is divided into four books. The first of these, containing seven articles, deals with fundamental principles. The second book, with 52 articles, has provisions for the organization of the regulating agency - the National Telecommunications Agency - intended to have the maximum degree of independence allowed under the Brazilian Constitution concerning sectoral policies. Book III, having 126 articles, is very innovating in that it introduces the concept of service provided in the public domain, in contradistinction to the traditional public service for the telecom sector. The final book, with 21 articles, expounds provisions for restructuring and privatization of Federal telecom companies. In addition, there are ten articles (not constituting a book) regarding general and transitory provisions.

Parallel to the debate in the National Congress concerning the new law, the Ministry of Communications set out to develop measures in anticipation of the provisions of the future law. The principle focus of this activity was aimed at the institution of a regulatory agency and the development of fundamental aspects of the new regulation.

An important result of this action was the establishment of ANATEL - National Telecommunications Agency - the new Brazilian telecom regulatory agency. The promulgation of its regulations occurred in October 1997 together with the naming of its first Board of Directors⁹.

Regarding the details of the new regulation, mention must be made of the development of the general plan for approval and the general plan of services universalization goals. Both are instruments provided for in the new general telecom law which aims at maximum transparency for the sectoral regulation, as well as for the goals and objectives that are to be defined for telecom service providers in the public domain.

⁹ The Board of Directors has five members, with fixed terms, and is designated by the President of the Republic after being approved by the Federal Senate.

The final work relating to these documents was conducted by ANATEL, which submitted them to public consultation in order to hear the contributions of all interested parties, as provided for in the new law. In addition, by explicit determination by the law, the documents are submitted to examination by the ANATEL Advisory Council¹⁰ whose duty it is to give its opinion on the content.

Another point was in relation to detailing the restructuring and privatization model of Federal telecom companies. Besides refining the company restructuring model and aspects connected with privatization, the major objectives in this area are: identification and definition of problems that could be obstacles to effective privatization.¹¹

The principal product of this work is the proposal of a restructuring and privatization model for TELEBRÁS companies that, as provided for by the general law, must be approved by the President after public consultation.

In order to speed up the hiring process of specialized consultants for the tasks of economic and financial assessment, the company restructuring, planning and executing the sale of the companies that are to be privatized, the new law established its own proper method¹² with a register administered by the Ministry of Communications in order to fulfil the function of previously qualifying potential buyers. In addition, the law provides for the possibility that operational procedures typical of such a process may be the object of a contract with the Federal financing institution that has experience in the matter¹³, with coordination and monitoring of the associated activities being the responsibility of a Special Supervisory Commission¹⁴ created by the Ministry of Communications.

The selection process for consultants who are working on the TELEBRÁS System privatization process was done by BNDES (National Economic and Social Development Bank) from November 1997 to February 1998, with field work beginning in March 1998. The objective is to receive bids (bidding proposals) by the end of the first half of the year or during the first days of the second half of 1998.

¹⁰ The Advisory Council has 12 members, representing the Chamber of Deputies, the Federal Senate, the Executive Branch, users, telecom operating companies and representative entities from civil society.

¹¹ Normally, this work is done by consultants hired to perform the process of assessment and sale and constitute the so-called *prior adjustments*.

¹² Normally, these processes are governed by the general law for tenders (Law No. 8666/93).

¹³ The Ministry of Communications contracted the BNDES - National Economic and Social Development Bank - for these tasks. BNDES is the agency responsible for all Federal company privatization processes included in the National Programme for Privatization - PND - excluding telecom companies.

¹⁴ This Commission has, basically, the same powers granted to the National Privatization Commission by the same law that established the PND.

Concomitantly, the structural separation of operations referring to mobile cellular service was done in the TELEBRÁS System companies with a partial breakup of 26 of the 27 State operating companies in order to fulfil the explicit provision of the minimum law that provided that this measure be implemented within a period of two years dating from its promulgation.¹⁵

Also in order to fulfil the provisions of the new telecom law, the Ministry of Communications prepared two legislative bills, submitted to Congress in November 1997: one of them referring to the creation of the Telecommunications Services Universalization Fund and the other referring to the creation of a Telecommunications Technology Development Fund. These bills are still in their initial phase in the Chamber of Deputies.

3 Resources involved

To carry on all these activities the Ministry of Communications has relied, since 1996, on the support of international consultants who are experts in the various issues involved. These consultants were recruited by the ITU - International Telecommunication Union, under an agreement for cooperation with the Brazilian Government represented by the Brazilian Cooperation Agency - ABC¹⁶ - under the aegis of broader agreements between Brazil and the United Nations organization.

The agreement between the ABC and ITU was signed in April 1996. The first consultants were hired in July 1996 and worked throughout the second half of that year, assisting the Ministry of Communications in the development of the future economic modeling of the telecom sector and in the preparation of the project that resulted in the new general law of telecommunications. More than 100 consultants and professionals from the Ministry of Communications were involved in this work.

For the second stage of the work, consultants were hired to implement the National Telecommunications Agency for the development of basic regulatory aspects, for detailing the restructuring and privatization model of TELEBRÁS System companies, to separate the companies with regard to the structural separation of mobile cellular service and for implementing the so-called prior adjustments as mentioned above. In this stage, there are about 1 000 participants, 70% of which are from TELEBRÁS System companies.

The third stage, presently being developed, has the support of consultants hired by the BNDES with even greater participation, in absolute and relative terms, of human resources from the companies that are to be privatized.

¹⁵ This period was to terminate in July 1998. But to allow the implementation of the restructuring and privatization model, it was necessary to put the measure in practice prior to the beginning of the economic and financial assessment process of the companies, with a view to their sale.

¹⁶ The ABC is an agency under the Ministry of External Relations.