

## Step-in Rights and the Assumption of Post Default Projects by Financers

Article 27-A of the Law of Concessions (Law No. 13,097, of January 19, 2015) allows lenders and guarantors to take control or temporary administration of the concessionaire of infrastructure projects to promote financial restructuring and to ensure continuity of services. This “step in right,” as it is called, has not been used much in Brazil until now.<sup>1</sup>

Step-in rights are relevant to projects requiring large upfront capital expenditure, such as infrastructure projects. In these cases, the continuity of the enterprise is more advantageous to the creditor than foreclosing the collateral involved in the transaction. The reason is that, typically, the company’s assets by themselves are worth less than the debt incurred to acquire them.<sup>2</sup>

The transfer of control or temporary administration needs to be stated in the respective public contract and approved by the relevant concession authority. Public contracts already executed at this date by and between the concessionaire and the public authority may or may not contain a step-in clause.

Should a step-in clause be provided, step-in implementation will be conditioned to authorization of the relevant concession authority. Issuance of the authorization is mandatory in case all of the conditions foreseen in the contract are fulfilled. Demonstration of the legal and fiscal good standing of the financer may be required. Whereas evidence of technical capability to operate the project may also be required, this will not typically be necessary under a well drafted step-in clause. On the other hand, if the technical capability requirement exists, it may be met by appointment of a qualified technical operator.

On the other hand, the public contract can be amended to insert step-in rights in the case it has been signed without them. In this alternative scenario funds will have already been disbursed and performance will be underway. The public contract is, essentially, an agreement guided by the public interest executed by the Public Administration and a private sector entity. As the public interest is a dynamic concept, in case of financial crisis involving the private party, the amendment of the public contract is justified.

The law allowing for the amendment of public contracts is Law No. 8,666, of June 21, 1993 (the Bidding Law),<sup>3</sup> which lists those instances when amendment is justifiable (Article 65). Amongst those situations, one draws special attention: public contracts can be amended should replacement of the performance guarantee be appropriate (Article 65, II, “a”). This should be enough to justify the inclusion of step-in rights in public contracts as, in economic terms, said inclusion works to strengthen the contract’s other clauses and guarantees. More advantageous to the public interest than the replacement of a guarantee is the addition of a new one.

Another basis for the amendment of the public contract to include step-in rights is that it serves the public interest. Article 27-A of the Law of Concessions states that the clause operates to ensure the continuity of the project even in a default scenario, in keeping with the traditional principles of Public Law. It is important to remember that the authorization for the exercise of the lender’s right to access the project can be obtained at the same time as the amendment of the public contract inserting the step-in clause, depending on the specific rules issued by sector regulators.

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<sup>1</sup> See *Step-in Rights: A solution for Investments in the Electric Energy Sector?* in our previous Legal Bulletin.

<sup>2</sup> The port sector is an example of a sector which can benefit from step-in rights. See *Brazilian Port Sector Financing: The Step-in Right* in our previous Legal Bulletin.

<sup>3</sup> In addition to Law 8,666/93, there are specific rules governing the public services concession contracts: Law 8,987, of February 13, 1995; Law 11,079, of December 30, 2004; and Law 9,074, of July 7, 1995.