

Government interest in petroleum and natural gas

I. – Introduction

1. – We are now in the midst of the process of transformation of the government role in the Brazilian economy. In the last few years, the Brazilian Government has been transferring to private enterprise the responsibility for developing the Brazilian economy, reserving for itself a role of fundamental importance, that of regulating and monitoring the market.
2. – This process started in the petrochemical area, was implemented in the steel sector, the electric sector and the telecommunications sector, and now returns to the starting point, all in the process of making the petroleum and natural gas commercial development and production monopoly more flexible.
3. – After Constitutional Amendment No. 9 of November 10, 1995, which allowed the activities of petroleum and natural gas to be commercially developed by concessions granted by the public authorities to private companies, Law 9478/97 was published, regulating these activities.
4. – It is anticipated in the next six months that the Brazilian Petroleum Agency (ANP) will start its bid proceedings, with an eye to granting private companies the right to commercially exploit and produce both petroleum and natural gas in Brazilian territory.
5. – In order for this phase of the monopoly lifting process to commence, it was essential to define the rules of one important aspect of this type of business: government participation owed by the companies that wish to commercially develop and produce petroleum and natural gas in Brazil.

II. – Law 9.478/97 and Decree 2.705/98

6. – Government participation is set out in Section VI of Law 9478/97, and the criteria for calculation and collection were recently defined in Presidential Decree 2705, published in the Official Gazette on August 4, 1998. Pursuant to article 45 of Law 9478/97, government fees that are owed by the companies involved in these commercial development activities in Brazil are as follows:

- I. – signature bonus;
- II. – royalties;
- III. – special participation; and
- IV. – payment for land occupation or retention.

7. – Please note that only royalties and payment for land occupation or retention will necessarily be charged of any and all companies that may sign concession contracts with ANP for commercial development of petroleum and natural gas. The other fees owed could be waived by ANP, pursuant to the criteria set out in Decree 2705/98.

8. – The **signature bonus** corresponds to the consideration offered by the bidder in the proposal for obtainment of the concession to commercially exploit petroleum and natural gas, and should be paid at signature of the respective concession contract. Its payment could be waived by ANP in areas of lesser economic relevance. When required, its minimum value will be established in the public bid notice published by ANP at the start of the bid process for awarding of the concession contract.

9. – The **royalties** correspond to the main financial compensation owed the Brazilian Government by any companies that are commercially exploiting petroleum or natural gas reserves in Brazil. The royalties will correspond to 10% of the total volume of petroleum and natural gas production achieved for each field.

10. – In order to calculate the royalties owed, the weighted average of the sales prices for petroleum or natural gas charged by the company developing the field in the respective month in normal market conditions, or the minimum price established by ANP, whichever is greater, should be adopted. When making this calculation, no taxes levied on the sale will be taken into account.

11. – The royalties due should be paid monthly in Brazilian legal tender (the *real*) as from the month in which production of the field being exploited starts, and the concessionaire company must forward to ANP on or before the fifth business day of the subsequent month a statement that it has drafted on field production, together with a voucher substantiating payment of the amount owed. *Production* is defined as the group of coordinated operations for extraction of petroleum or natural gas from a deposit.

12. – Taking into consideration the geological risks, the expectations as to production and other factors pertaining to each area to be commercially exploited, ANP can provide in the respective concession bid notice for a reduction in the royalties percentage mentioned above to the minimum of five percent of the total production value. The percentage adopted for each case must be set forth in each individual concession contract.

13. – Please note that the gas burned for flares, rather than sold, as well as products lost while being handled by the concessionaire, will be included for purposes of calculation of the royalties owed when calculating the total amount of field production.

14. – Law 9478/97 does not however define whether any products lost due to someone other than the concessionaire will also be included in the royalties' calculation. Taking into consideration that the royalties are normally assessed on the economic use achieved by the company working the field, we think that, in cases in which it is not proved that the company culpably wasted the product, this lost production should also be disregarded when calculating the royalties.

15. – The **special participation** consists of an extraordinary financial compensation due quarterly by the concessionaire companies engaging in exploration and production of both petroleum and natural gas, and is only charged in the event a great volume is produced or the field has an exceptionally high yield.

16. – The definitions for *great volume* and *high yield* are set out in Decree 2705/98, and vary depending on the number of years of production and the location of the area being worked, i.e., the land, lakes, the

continental platform in shallow or deep waters.

17. – The **special participation** rate varies from 10 to 40%, depending on the volume for each quarter, and is figured on the gross production revenues, less royalties, investments for exploration, operating costs, depreciation and taxes pursuant to prevailing law.

18. – Please note that the revenues from the quarterly production of a certain field, when negative, can be offset against the revenues for subsequent quarters, for purposes of figuring the **special participation**.

19. – **Payment for land occupation or retention** should be made annually by the concessionaire, as from the date of signature of the concession contract, and the amount will be set in the public notice and the respective contract for concession for commercial development of petroleum and natural gas.

20. – The price per square kilometer, adopted for purposes of calculating payment due to occupation or retention of the land, could vary at the discretion of ANP between R\$ 10,00 and R\$ 500,00 for the exploration phase, between R\$ 20,00 and R\$ 1.000,00 for the development part of the production phase, and between R\$ 100,00 and R\$ 5.000,00 for the production phase, depending on the geological characteristics, the location of the sedimentary basin in which the block under concession is located, as well as other pertinent factors.

21. – In the event that the concessionaire were to file for extension of the exploration stage, the value of the **payment for land occupation or retention** will be augmented by 200% of the value set for the exploration phase.

22. – For those cases in which the exploration area is located onshore, the concession contract will also contain a clause setting out payment to the landowners for a participation equivalent to a percentage varying between zero point five percent and one percent of the production of the petroleum and natural gas, at the discretion of ANP.

23. – Finally, please note that, according to article 31 of Decree 2705/98, Petrobrás is subject to payment of the same governmental participation fees as any private company.

III. – Conclusion

24. – According to calculations that have been published in the press, ANP believes that the maximum total percentage of government participation fees that will be owed by the companies that wish to commercially develop petroleum and natural gas in Brazil should correspond to 55%.

25. – Should this percentage be confirmed, we believe that Brazil will be entering the international petroleum and natural gas market on a competitive basis, as it is usual on this market to have government stakes ranging from 50% to 90%. In fact, a substantial increase in foreign investments in Brazilian petroleum and natural gas is expected.

26. – In our view, Brazil has taken a giant step towards becoming competitive on the worldwide petroleum and natural gas scenario and achieving autonomy in this sector. It will however be necessary to identify a tax structure compatible with this market, thereby paving the way for a dynamic new

chapter in the history of petroleum and natural gas production in Brazil.

Date Created

05/09/1998