The New Oil and Gas Industry in Brazil: An Overview of the Main Legal Aspects

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SUMMARY

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I. INTRODUCTION

The challenges of the 1990s were faced by the Brazilian economy with a drive towards decreasing the share of the state's participation. The large privatization program initiated in the early 1990s set forth the basis and was strengthened with the approval of the so-called Concessions Law in 1995.[1] This law, on which we shall comment further in this article, allowed a framework to attract foreign and national private capital to big projects of electric generation, telecommunication, transportation, and other projects, which were formerly under state control. In a way, this process may be viewed as a revival of the concession already encountered in Brazilian law in earlier stages.[2]

The understanding of the opening process applicable to oil and gas requires a brief understanding of the principles underlying the overall process of opening the Brazilian economy. With this goal**,** it is interesting to analyze the evolution and proposals of the privatization and deregulation program,[3] which shows a switch from direct participation in

1. The Privatization Law was the basis for the privatization program launched by the Collor Government in the early 1990s. Decreto No. 8031, de 12 abril 1990, D.O.R.J., de 13.04.90 [hereinafter Decreto No. 8031]. It was strengthened by various measures carried out in recent years, the culmination of which is Law 9491. Decreto No. 9491, de 9 setembro 1997, D.O.U., de 10.09.1997.

2. Arnoldo Wald describes the importance of the concession law within the framework of the Brazilian economy:

> One cannot understand the practical importance of the Concession Law to Brazil, without evoking the economic context in which it was drafted, aiming at avoiding the infrastructure deficit, which increases the public deficit, not only for the expenses it generates, but for the lack of new resources, which could be collected, by the State, to better accomplish its role in essential fields like education, health and safety.

ARNOLDO WALD, O DIREITO DE PARCERIA E A NOVA LEI DE CONCESSÕES: ANALISE DAS LEIS [PARTNERSHIP LAW AND THE NEW CONCESSIONS LAW: ANALYSIS OF THE LAWS] 225 (1996).

3. First, to understand the referenced subject, it is important to distinguish between "privatization" and "denationalization." Privatization is the process of transferring something from state ownership to private ownership, whereas denationalization indicates the state's withdrawal from a certain sector of activity. As the corner-stone of the restructuring of state's role in the economy, Law 8031 adopted the term "privatization." Decreto No. 8031, *supra* note 1. Nevertheless, Law 9491, which expressly revoked the former statute, abandoned "privatization" and established the use of "denationalization." *See* Decreto No. 9491, *supra* note 1; JOSÉ MANUEL CARVALHO FILHO, MANUAL DE DIREITO ADMINISTRATIVO [MANUAL OF ADMINISTRATIVE LAW] 243 (5th ed. 1999).

Second, in accordance with Articles 1, 2, and 4 of Law 9491, one may assert that the Brazilian Denationalization Program targets the accomplishment of "a new governmental strategy, *i.e.* the state's withdrawal from the economy and the transfer of state-run activities and services to private enterprise." In other words, the Program announces the end of an economic intervention model in which the state undertook "many entrepreneurial activities and public services, with endless spending and low efficiency." *Id*.

economic activities through state companies to survey and control through governmental agencies.[4]

Oil and gas, however, had long been under a separate track from mining in the statutory and lower level legislation, although with a common doctrinal background and under the same governmental entity supervision.[5] Beyond the constitutional framework that allowed ownership of mineral resources by the state, the legal basis for the oil and gas regime in Brazil was set forth by Law 2004/53, which followed a big campaign over the ownership of oil and gas by the Brazilians.[6] The slogan of such campaign, the "Petroleum is Ours" ("*O Petróleo é nosso"*), was always mingled with the image of Petróleo Brasileiro S.A. (Petrobras), the company created in 1953 to carry out the activities of the monopoly.[7] This whole process seemed to qualify Brazil as a "visible absence" in the international scenario, as we can verify in the lack of any reference to Brazil in the epic book, THE PRIZE, by Daniel Yergin.[8]

The summary of the evolution of the legal background for oil and gas in Brazil and the dramatic switch represented by the Federal Constitution of 1988 indicate that this field of activities was still the most difficult area for opening to private investors in the country.

II. HISTORICAL AND DOCTRINAL BACKGROUND

The evolution of the legal regime applicable to oil and gas in Brazil may deserve a more specific analysis from the perspective of constitutional law, at least with a simple comparison of the wording of the articles in the constitutions applicable to oil and gas prior to 1988.[9] Until then, since there was no formal prohibition, an enlargement of the notion of service contracts already performed by Petrobras with service contractors for usual services in the industry allowed the introduction of a hybrid type of contract, called "Service Contract with Risk Clause."

In the international panorama of oil and gas contracts, the evolution was already paving the way for the hybrid contracts of the 1980s, which merged characteristics of models adopted in other countries and challenged the initial classification of exploration and production contracts.[10] The Chinese missions that were in Brazil in the late 1970s certainly

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4. *See id*. at 244.

> Parallel to the transfer of activities to private enterprises, autonomous agencies, also called regulating agencies or government agencies, have been created. A corollary of the Denationalization Program, these agencies are responsible for controlling private enterprises with the purpose of maintaining their adjustment to the Program's fundamental postulates and to public interest and of preventing any type of entrepreneurial behavior that may reveal abuse of economic power.

5. The Ministry of Mines and Energy has already undergone various changes in its designation and area of influence. It encompasses in the present stage the link to oil and gas matters, but also in general to energy, water, and mines.

6. Decreto No. 2004/53, de 3 de octubre de 1953, D.O.U. de 3 de octubre de 1953 [hereinafter Decreto No. 2004].

7. *Id*. A majority of the 56 articles in Law 2004/53 were actually dedicated to Petrobras.

8. *See generally* DANIEL YERGIN, THE PRIZE: THE EPIC QUEST FOR OIL, MONEY AND POWER (1991).

9. From the Constitution of 1967, we can identify the wording which would later be expanded under the wording of the Constitution of 1988: "The research and *production* (lavra) of petroleum in national territory are the monopoly of the Federal Government, in terms of the law . . . ." (emphasis added). *See* C.F. of 1969, art. 169, *modified by* C.F. of 1988, art. 177.

10. Various authors adopted the functional classification of exploration and production contracts. *See, e.g.,* ZHIGUO GAO, INTERNATIONAL PETROLEUM CONTRACTS: CURRENT TRENDS AND NEW DIRECTIONS (1994). The peculiarities of hybrid contracts are such that "it is difficult to make generalizations about the hybrid contract." *Id*. at 203. "As for its basic distinctive feature, suffice it to that is very flexible in incorporating various elements

studied many contracts around the world trying to learn from other countries' experiences and also analyzed the Brazilian model, importing some of its elements.

If we try to account for the main phases of petroleum legislation in Brazil, we need to identify the first period, prior to 1938; a second from 1938, when the national Petroleum Council was created; and a third, from 1953, when Law 2004 created Petrobras. Although 1977 can be referred to as a significant year, because of the adoption of risk contracts, the third period actually lasts from 1953 until 1995, when Constitutional Amendment Number Nine introduced the change to the 1988 Constitution, which suppressed the prohibition concerning risk contracts. The evolution shows that Law 2004 was strong enough to be in force for over 40 years and flexible enough to render possible the changes that happened in between, having been kept in force by the constitutions, and being compatible with the rise and fall of the risk contracts. The fourth period started with the big change represented by Constitutional Amendment Number Nine of 1995, but started to be really implemented with the enactment of Law 9478,[11] which actually started the new regime for oil and gas in Brazil.

A. Internationalization

The big trend towards change was already embodied in Article 41 of Law 2004,[12] which allowed Petrobras to perform its activities internationally directly or through subsidiaries. This basis enabled internationalization of Petrobras, first through the creation of Petrobras Internacional S.A. (Braspetro), which still did not have to date an accurate account of its story and memories.[13]

The division of Braspetro's initial commercial activities gave rise later to another further step towards internationalization through the creation of the commercial subsidiary Interbras, an outstanding expansion of Petrobras activities in the trading arena beyond the oil and related commodities,[14] which was extinguished by the Collor Administration in the

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of existing agreements." *Id*. at 203. "Its legal nature is often: risk with title to share management and production." *Id.* at 204.

"[T]he government's control over its resource development and foreign operations increases from the modernized concession to the [Risk Service Contract (RSC), in Gao's terminology], or alternatively, the foreign company's autonomy decreases from the modernized concession to the RSC." *Id*. at 204.

"[G]overnment-company relationships can be summarized as follows. Under the law of modern concession contract, the concessionaire works essentially for itself. Under the production-sharing contract and the risk service contract, the contractors work primarily for the government. Under the hybrid contract or a joint venture contract, the foreign company works in association with the state oil companies." *Id*. at 204.

Other authors have built the notion of a functional analysis of the exploration and production contracts. *See generally* Peter Cameron, *The Structure of Petroleum Agreements*, *in* PETROLEUM INVESTMENT POLICIES IN DEVELOPING COUNTRIES 29 (Nicky Beredjick & Thomas Wälde eds., 1988); Remo Mannarino, *Aspectos Econômicos e Negociais do Contratos de Risco*, *in* AS JOINT VENTURES NA INDÚSTRIA DO PETRÓLEO: TEMAS DE DIREITO PETROLÍFERO E DE DIREITO DO COMÉRCIO INTERNACIONAL [*Economic Aspects and Negotiations of Venture Contracts*, *in* JOINT VENTURES IN THE PETROLEUM INDUSTRY: ISSUES ON OIL LAW AND INTERNATIONAL COMMERCIAL LAW] 132–33 (Marilda Rosado de Sa Ribeiro ed., 1997) [hereinafter JOINT VENTURES].

11. Decreto No. 9478, de 6 de agosto 1997, D.O.U., de 07.08.1997 [hereinafter Decreto No. 9478].

12. Article 41 under Law 2004 had the following approach towards internationalization: "Directly or through its subsidiaries, in association with third parties or not and without the limitations provided for in Article 39, Petrobras may exercise outside the national territory those activities mentioned in Article 6." *See* Decreto No. 2004, *supra* note 6.

13. *See generally* ROBERTO SOUZA, PETRÓLEO: HISTÓRIAS DAS DESCOBERTAS E O POTENCIAL BRASILEIRO [PETROLEUM: STORIES OF DISCOVERIES AND THE BRAZILIAN POTENTIAL] (1997). The author focuses on the oil and gas exploration in Brazil, but presents his personal international experience about certain facts involved in the internationalization process, mostly the presence of Petrobras in Iraq. The book serves to confirm and to lend some light to the understanding of Braspetro's role.

14. For a case study of Interbras as a trading company, *see* JUAN LUIS COLAIACOVO & OSCAR YCIZ CENDOYA, II TRADING COMPANIES (II)—EXPERIÊNCIA DE BRASIL, TEXTO Y CASOS (1989).

early 1990s. The extinction of Interbras and its impact to Petrobras' international activities still need an adequate understanding and accurate analysis.[15]

The big move towards exploration abroad enabled the discovery of the Giant Majnoon Field in Iraq. That achievement, in its turn, associated with the rise of the expertise of Petrobras in deep waters in the 1980s, increased the partnership possibilities differently from the initial stage when Braspetro performed alone, assuming a hundred percent of the risk of the ventures abroad.

To understand properly the process by which Brazil is opening its oil industry, we need a closer look at what happened in the 1970s and in the 1980s. On the outer frontier, Petrobras, through Braspetro, was expanding acreage and experimenting with partnerships. In the late 1980s, Braspetro opened subsidiaries in the first-world nations, such as Norway, United States, and Great Britain.[16]

In the domestic arena, a lot could be learned from the role performed by the Research Center (Centro de Pesquisa e Desenvolvimento da Petrobas (CENPES)) with the joint industry projects executed with the industry and with foreign and local universities.[17]

B. Risk Contracts

The decision for the adoption of the Risk Contracts is President Geisel's, following congressional internal studies made at Petrobras.[18] The decision was not embodied in a decree, nor was it subject to debate, rather it was based upon the Three Ministers' Justification in 1977,[19] generating thereafter a great controversy about the constitutional validity of those contracts and other issues.[20] Studies from scholars during this time already commented on the contract's hybrid nature for Brazilian law standards.[21] The risk contract

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15. Many of the essential activities that needed to be performed through a subsidiary abroad were thus transferred to Braspetro's subsidiaries, which started to encompass a growing mixture of different and conflicting roles. On the other hand, in addition to its natural difficulties, which mainly involve complex and scattered activities abroad, Interbras was involved in pending litigation regarding the liquidation process and investigations which reached the first phases of the liquidation itself. Although the liquidation itself ended in 1994, there were still matters pending abroad in 1999, because Petrobas was trying to collect credits abroad. Now the process is finally complete.

16. Comparing the presence of Braspetro on the world map in the annual reports and in the internal studies carried out by its planning experts showing different stages of its activities, it is clear that partnership possibilities started in the early 1980s. An important move was its presence in developed countries developed in the late 1980s. The same must be said about a more consistent presence in Latin America, after some moves of leaving and returning to the same country, such as, for example, Colombia.

17. The Research Center took a leading role in many such projects by creating a special section that took care to follow-up; opening the way for future developments of the geochemistry excellence program, a paradigm in the oil industry in Latin America; and allying with major oil contractors when Petrobras could not afford it. Holding was not actually and officially open to such cooperations. Prior to the official partnership process within the scope of the new Petroleum Law, various Memoranda of Understanding were signed by the Holding Company Petrobras, aimed at the formation of a joint company, such as the one executed with PDVSA.

18. These studies could already be based on Braspetro's experience abroad, since it had access to the Iranian and Iraqi models.

19. Exposição de Motivos Interministerial No. 177/76 [Interpretation of Interministerial Motives] (1977).

20. *See generally* JOINT VENTURES, *supra* note 10. There are no traces of consistent challenges (doctrinal or otherwise) in court based on these constitutional grounds, but the controversy finally evolved into pressure placed on the Congress, which resulted in the prohibition set forth in the 1988 Constitution. Worth mentioning, although focused on other aspects, is the big suit involving the contracts executed with Paulipetro, a consortium formed by the São Paulo State.

21. *See id.* at 134–35; SÍLVIO NEVES BAPTISTA, CONTRATO DE RISCO NO DIREITO BRASILEIRO, RECIFE [VENTURE CONTRACTS IN BRAZILIAN LAW] (1976) [hereinafter CONTRATO DE RISCO]; LUIS OLAVO BAPTISTA, O CONTRATO DE RISCO [THE VENTURE CONTRACT] (1976); GETÚLIO CARVALHO, PETROBRÁS: DO MONOPÓLIO AOS CONTRATOS DE RISCO [PETROBRÁS: THE MONOPOLY OF VENTURE CONTRACTS] (1977); Sérgio Amaral & Carlos

is a work contract (empreitada) under which the contracted company supplies some material. This denomination is an elliptical phrase that means "work contract with price risk clause."[22]

Viewed from abroad, the features of the risk service contracts were subject to many scholarly comments.[23] They were also depicted by certain commentators, from a political point of view, as the most progressive of the contractual forms then in operation. Professor Gao even went further to prescribe it as an interesting option for host countries wishing to assure a greater degree of control over the investors and to keep a survey of the operations:

> Under the risk service formula, Brazil's state oil monopoly remains unharmed as a result of the use of "hired services." For this reason, the RSC is recommended to those developing countries that are considering moving in the same direction, but fear being deprived of their sovereignty over petroleum resources.[24]

The comparison with the production sharing contract was inevitable, although it was acknowledged that it was "similar to the PSC, but differs in certain important matters."[25] The contract was usually compared to other experiences:

> The Brazilian agreement is not entirely typical. The provision whereby Petrobras takes over operation of the wells after the development phase of the contract has been concluded distinguishes it from many risk service contracts that provide for continued operation by the foreign company. In addition, the foreign company's rights in the oil produced are generally less favorable than those usually found in such agreements. A foreign company contracting with Petrobras merely has a "buy back" right entitling it to purchase a limited amount of the oil it produces at the market price.[26]

Stable parameters of risk contracts throughout the years include:

- exploration commitments and gradual reduction of the service area are explicitly established according to a minimum program;
- after evaluation and declaration of commerciality of a field, the area is delimited for the subsequent steps, *i.e.,* development and production;
- the host country assures control, supervision and monitoring of operations, as long as personnel training is provided and local legislation is respected;
- local products and personnel are preferred; among the economic aspects and in case of commercial discovery, reimbursement of exploration and development expenses is due in periodic installments and predetermined terms, but only after commercial production has started; in some cases payment may be in oil instead of cash; and

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Cesar Andrade, *Notas Sobre o Modelo Brasileiro de Contrato de Risco*, 5 SEMINÁRIO DO SERVIÇO JURÍDICO DA PETROBRAS [*Notes on the Brazilian Model of Venture Contracts*, 5 THE LEGAL SERVICE SEMINAR OF PETROBRAS] (1977) (on file at Petrobas Legal Library).

22. JOINT VENTURES, *supra* note 10, at 134.

23. "The type of arrangement that long typified international petroleum transactions in Latin America was the risk service contract. Under such an agreement, a foreign oil company contracts to explore a specified area and evaluate any discoveries." ERNEST E. SMITH ET AL., INTERNATIONAL PETROLEUM TRANSACTIONS 379 (1993).

24. GAO, *supra* note 10, at 141.

25. *Id*. at 203.

26. SMITH, *supra* note 23, at 383.

- in the Brazilian risk contract model, one can highlight the adoption of the so-called *ring fence mechanism*, by which payment of contracting companies shall be done with resources from the corresponding oil field.[27]

In terms of the balance between the interests of the host country as opposed to the international oil companies, some view it as less favorable to the oil companies:

> The RSC is an arrangement that can finally ensure the host country's full ownership of its oil, direct control of its exploitation, and complete appropriation of the production. On the other hand, this form is the "least attractive" of the options open to oil transnationals, since despite assuming all the exploration and development risks, the remuneration to the company does not include access to crude oil. Thus, the legal nature of the service type of contract is: risk without title of oil.[28]

C. Nationalism X Opening

One can state, undoubtedly, that there existed a nationalistic imbedded belief which has been manifesting itself at the congressional level as a pendulum, present not only when it inspired the changes effected in the Federal Constitution of 1988, which forbade the execution of new risk contracts in paragraph one of Article 177.[29]

It was still present in 1995, because of the somewhat long process for the implementation of changes. Two years went by from when Ninth Amendment introduced the radical change that opened the way for the new Petroleum Law until the enactment of Law 9478 in August 1997.[30] Another two years elapsed from the law in 1997 until the First Bidding Round in 1999. A lot has to be understood from those transition periods to account for the present situation when we really can speak of a new Brazilian oil and gas legal regime.

D. Legal and Doctrinal Background

The most recent radical change in the legal framework of the oil and gas industry in Brazil stems back to Ninth Amendment to the Federal Constitution of Brazil, approved in

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27. *See* JOINT VENTURES, *supra* note 10, at 136.

28. GAO, *supra* note 10, at 203.

29. The Constitution of 1988 was welcomed, in many aspects, as the Constitution of Citizenship. It actually incorporated many provisions of the nationalistic approach. For instance, the notion of a Brazilian company of Brazilian capital enlarged the restrictions based on the criteria of control, which existed before in the lower level legislation. Its expansion for oil and gas matters was seen with some skepticism from abroad:

> This constitutional monopoly provision is the culmination of the Brazilian oil nationalism movement. It prohibits the use of any type of risk-taking agreement for petroleum exploration. Fortunately, the latest Constitution contains a transitional provision which reads that "risk contracts concluded with Petróleo Brasileiro S.A. (Petrobrás) for petroleum exploration and that are in force on the date of the promulgation of the constitution are hereby exempted from the prohibition." By so providing, the new Constitution explicitly validates all existing service contracts, which was a great relief to foreign service contractors.

Id. at 109.

30. "Clearly, the controversy over oil in Brazil has been an ideological and emotional problem." *Id*. at 113.

1995.[31] The latter, enacted in 1988, not only kept the monopoly and the role of Petrobras, but also cemented its constitutional status. This amendment maintains the status acquired by oil and gas policy, while radically reversing its intrinsic ideological tendencies.

A more detailed examination of the evolution would confirm this overview.[32]

The process of change that has been happening in Brazil in the oil and gas industry has a deep impact, the effects of which are yet to be fully analyzed and understood. Part of such impact results from the process of reception of concepts, contracts and institutions borrowed from international traditions developed in the last fifty years, when oil and gas reached a more mature stage in other countries, where it had long been open to the private sector. With new businesses and deals which had never been performed here paving the way for new contracts in the Brazilian scenario,[33] there will certainly be further developments resulting from such adaptation within the context of Brazilian legal tradition.

Sketches providing an overview of the challenges and some of the key issues involved in the opening of the Brazilian oil and gas industry[34] have attempted a brief introduction to the legal and conceptual background of Law 9478, the Petroleum Law in Brazil.[35] In the course of 1998 and 1999, there have been major and structural changes underway.

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31. *See* C.F., art. 177:

> It is a monopoly of the Federal Government:
> I. the research and mining/production of the petroleum and natural gas and other fluid hydrocarbons;
> II. the refining of the national or foreign petroleum;
> III. the import and export of the products and by-products result of the activities foreseen in prior provisions;
> IV. marine transportation of the crude petroleum from national origin or of basic by-products of petroleum produced in the country, as well as the transport by pipelines of the crude oil, its by-products and natural gas from any origin;
> V. research and mining/production, the enrichment, the reprocessing, the industrialization and the commerce/trade of ore and nuclear minerals and its by-products.
>
> § 1—The Federal Government may contract with state or private companies the performance of the activities foreseen in the items I and IV of this article, subject to the conditions established by law.*
> § 2—The law referred to in the first section will set forth:**
>
> I. the guarantee of the furnishing of the by-products of petroleum in all of the national territory;
> II. the conditions for contracting;
> III. the structure and roles of the "*regulatory agency*" of the Federal Government monopoly;
>
> § 3—The law will set forth the terms for the transportation and the utilization of radioactive materials in the national territory.***

* Modified by Constitutional Amendment 9/95. The Federal Government may contract the performance of the activities foreseen in the items I and IV of this article, with estate and private companies observing the conditions established by law.

** Modified by Constitutional Amendment 9/95.

*** Renumbered by Constitutional Amendment 9/95. The law set forth the terms for transportation and utilization of the radioactive materials in the national territory.

32. Prior to 1934, when the Constitution introduced the concession system, there was Decree 24642, where the concession system was defined. *See* JOINT VENTURES, *supra* note 10, at 16. More recently, *see* PAULO VALOIS, A EVOLUÇÃO DO MONOPÓLIO ESTATAL DO PETRÓLEO [THE EVOLUTION OF THE STATE PETROLEUM MONOPOLY] (Lumen Iuris ed., 2000).

33. With the adoption of the joint operating agreement and the farm-outs, for instance, many concepts of Brazilian law had to be analyzed to accommodate the international oil and industry practices. Some drafts adopted by Petrobras in its first partnership process benefited from the comparative studies performed by the author with the background of BRASPETRO's practical experience abroad.

34. Marilda Rosado de Sá Ribeiro, *Current Practice: Brazil*, 17 J. ENERGY & NAT. RESOURCES L. 75 (1999) [hereinafter Rosado, *Current Practice*].

35. Decreto No. 9478, *supra* note 11.

Although the process has been long, if we take 1995 as one of the basic starting points, many definitions and guidelines were still to be issued in the following years.

E. Doctrinal Tradition

There are many important matters to be understood in the light of the doctrinal tradition in Brazil. The evolution of the doctrines concerning the property of mineral resources has a strong analogy to the accounts made by international sources. On the other hand, there was not a specific interest on the tracking of the evolution of such concepts as applied to oil and gas. The concepts focused on international sources, both from doctrine and precedents that did not have a parallel in Brazil, where the studies focused on the mineral property theories in their broad features.[36] Until 1997, there had been no comment among Brazilian authors on analogous concepts to the evolution of the rule of capture or the correlative rights doctrine that exists in the legal history in the United States.[37]

III. LAW 9478: MAIN FEATURES

Law 9478 has inaugurated many fundamental matters never contemplated under Brazilian law, but also further defined some aspects that need to be envisaged within the framework of the other laws already in force.[38]

As a general outline, Brazilians usually say that the monopoly is now rendered "flexible,"[39] because although ownership of petroleum resources is still vested within the state, the exclusive performance formerly granted to the more than forty-year-old state-owned company Petrobras is now open to private companies through the execution of concession contracts for the upstream activities or through authorization for the downstream.

Concerning the upstream, some analysts might identify in the Brazilian approach an inspiration in the Norwegian and British licenses. From the former, we can identify the two-fold presence of the state both through a regulatory agency, the National Petroleum Agency (ANP), which would have the supervisory and control functions somewhat analogous to the Norwegian Petroleum Directorate and through an entrepreneurial function to be left to Petrobras in a role equivalent to Statoil.

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36. *See*, JOINT VENTURES, *supra* note 10, at 15.

37. *Id.* at 18–19.

38. We shall refer in particular to the so-called Concession Law. Decreto No. 8987, de 13 fevereiro 1995, D.O.U., de 14.02.1995 [hereinafter Decreto No. 8987]. Regarding concerns in joint ventures under Brazilian law, we shall refer to the now old New Corporation Law, dated 1976, complemented and partly revised in other matters by Law 9457. Decreto No. 9457, de 5 de maio de 1997, D.O.U., de 6.05.1997.

39. The forecasts made about Brazil already identified this trend.

> As a matter of fact, privatization or majority privatization of Petrobrás [sic] has been ruled out by the government and most members of the congress, who are currently reviewing the country's 1988 Constitution. Nonetheless, "flexibility" has been widely accepted as an alternative, with a long wish-list of changes, including the possible return of foreign oil companies under risk contract terms. In view of the wave of privatization sweeping state oil sectors worldwide, the hard reality of the deterioration in Petrobrás' [sic] finances, and the growing public acceptance of the concept of privatization and the need to accelerate the process of deregulation, it is highly likely that the Constitution will be amended to allow the return of the RSC.

GAO, *supra* note 10, at 114.

This resemblance might be misleading, however, since there is not a policy of mandatory participation of Petrobras in the joint ventures, as was the case for Statoil in the 1980s. Petrobras should compete, and it would be ready for it, according to its official spokesmen. More recently, a major structural change in Petrobras' international activities has been approved and is being commented in the Brazilian and in the international press.[40]

A full and complete analysis of the law should address all of its articles, which goes beyond the scope of the present overview. We wish to address the main issues for the upstream side of the business, such as the meaning and implications of the transition period for Petrobras, the legal nature of the concession in Brazil, some principles set forth in the law for the exploration and production, and the guidelines for the concession contract.

A. Transition for Petrobras

For outsiders it is not easy to understand the status of Petrobras in the new scenario. On the one hand, Petrobras is still a state company, because it is controlled by the Federal Government.[41] It is subject to many constraints, in the sense that, as a state company, many rules of survey and control are subject to governmental policy. Its budget for investment, for instance, is subject to the policy concerning the overall federal budget, and its capacity to contract foreign loans is subject to limitations.[42]

One has to acknowledge, on the other hand, that Petrobras shares have long been negotiated in the stock exchange. That renders the expression "privatization of PETROBRAS" not fully applicable. In this sense, the Brazilian case must be studied while bearing in mind not only the conceptual background, but the legal nature of mixed-economy companies and the political background of the approval of Ninth Amendment and of Law 9478 by the Congress. The legal regime for mixed-economy companies is the regime of private companies in all matters related to labor and others, and it has been the object of many competent studies in Brazilian law.[43]

The Petroleum Law in a way followed such trend, reserving for Petrobras the role of an economic agent from the private sector. That law opened a pathway so that a new framework for contracting of services and goods may be issued exclusively for Petrobras,

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40. The press interviews account for a reduction of Braspetro's role, which would be taken up directly by the holding company.

41. The General Assembly Minutes of Meeting indicates that the corporation is controlled by the Federal Government and linked to the Ministry of Mines and Energy, and that the Government's control shall always be kept through ownership and holding of, at the minimum, fifty percent plus one of the voting shares. Four of the Bylaws indicate the number of ordinary shares with voting rights and preferential shares without the right to vote. *See* General Assembly Minutes of Meeting, Mar. 24, 1999, *reprinted in* OFFICIAL GAZETTE, May 21, 1999, at 15–18.

42. According to numbers revealed in a recent presentation at the Brazilian Petroleum Institute and in an interview with Mr. Fernando Lucchesi, Head of Petrobras Planning Department, the 2000 budget is RS$3.8 billion for the holding, RS$1.2 billion for its subsidiary Braspetro/Brasoil, RS$300 million for BR (distribution) and RS$100 million for Gaspetro.

43. Many authors already discussed the legal nature of the mixed-economy company and most of them came to the same conclusion: this entity should be studied in conjunction with the public companies because of their similarities. It is included in the State's indirect administration as a private law entity, and its structure is organized in order to meet public and private interests. It is also created by legal authorization, like a corporation, with control of shares by the State. *See* MARIA SYLVIA ZANELLA DI PIETRO, DIREITO ADMINISTRATIVO [ADMINISTRATIVE LAW] 309, 312 (5th ed. 1995); TOSHIO MUKAI, DIREITO ADMINISTRATIVO E EMPRESAS DE ESTADO [ADMINISTRATIVE LAW AND STATE ENTERPRISES] 118–20 (1984); THEMÍSTOCLES BRANDÃO CAVALCANTI, CURSO DE DIREITO ADMINISTRATIVO [COURSE ON ADMINISTRATIVE LAW] 305–09 (7th ed. 1967); JOSÉ CARVALHO DOS SANTOS FILHO, MANUAL DE DIREITO ADMINISTRATIVO [MANUAL OF ADMINISTRATIVE LAW] 340–41, 343 (5th. ed., 1999).

freeing it, in a way, from the application of Law 8666, a code of conduct for state-owned companies of a very controversial nature.[44]

B. Principles Under Articles 31 Through 35 of Law 9478

The guidelines for the transition regime applicable to Petrobras are established in Section II, Specific Rules for the Activities in Progress. For certain critics it represented a privilege for Petrobras. The principles adopted therein must be commented, however, bearing in mind the major legal issues embedded in Brazilian law. The first of them is the acknowledgment that the investments made by Petrobras under the previous regime would require compensation and would be subject to court challenge in case such rights were not recognized. That must be put in line not only with Brazilian commercial law, where the rights of the minority shareholders have been gradually asserted, but also in the light of remedies available to any citizen who feels that deals involving public interest or destination of public monies are not proper.[45]

Many issues are naturally subject to different interpretations and a lot has yet to come in the process involving the succession of the ANP concerning the obligations of the former National Fuels Department (Departamento Nacional de Combustíveis (DNC)) and of some roles of Petrobras.

Article 31 contained the requirement that Petrobras would submit to the ANP its exploration, development and production programs with information and data that forced Petrobras into a whole internal evaluation of priorities. Based on internal discussions to comply with such requirements, Petrobras submitted requests, dividing the areas in red, elected for partnerships for the first portfolio, and blue, for its individual performance.[46]

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44. Decreto No. 8666, de 21 de junho de 1993, D.O.U., de 22.06.1993; *modified by* Decreto No. 8883, de 8 de junho de 1994, D.O.U., de 9.06.1994, Decreto No. 9032, de 28 abril de 1995, D.O.U., de 29.05.1995, Medida Provisoria No. 1.231-12/97 (regulating concessions and purchases made by governmental entities). Pertaining to Petrobras activities, *see* Decreto No. 2745, de 24 de agosto de 1998, D.O.U., de 25.08.1998.

45. These would be the sort of class actions, one of them named "açâo popular," through which any person can challenge in court a decision or act performed against public interest.

46. Decreto No. 9478, *supra* note 11.

> Article 31—Petrobras shall submit to ANP, within a deadline of three months from the date of the publication of this Law, its program of exploration, development and production, with information and data which permit:
>
> I. Knowledge of the activities of production in each field, in which boundary may include an area of technical safety;
> II. Knowledge of the activities of exploration and development, registering, in this case, the incurred costs, the investments in effect and the schedule of the investments still to be put into effect, in each block in which it has defined prospects.
>
> Article 33—In the blocks where, by the date of the commencement of the validity of this Law, Petrobras has effected commercial discoveries or promoted investments in exploration it may, provided there is capacity for investment, including that by means of financing (the one which comes from financing), proceed with the work of exploration and development for a period of three years and, in the case of success, proceed with the activities of production.
>
> Article 39—Petrobras shall have its rights confirmed for each one of the fields that are under effective production as of the date of entry to the validity of this Law.

The first request by Petrobras was submitted to the Agency within three months from the publication of the law, as foreseen under its Article 31. As a result, 397 concession contracts were executed between Petrobras and the ANP.[47]

Acquired rights to certain concessions were acknowledged by the law to the state company only concerning those areas where it had already started production (Article 32).

The other rights were subject to assessment by the Agency, according to principles set forth under Article 33, which gave rise to certain controversy. Concerning the specific issues under Articles 31 through 33, the disagreement centered around the concept of investment, whether it was encompassing enough to allow submittal of proposals by Petrobras already having negotiated with other companies the later application for farm-outs. That would mean the oil companies negotiating with Petrobras would enter into some areas in Brazil prior to the official Bidding Rounds to be promoted by the ANP.

Another relevant difference of interpretation was caused by the three year limit, and whether it allowed the extensions of the concession contract according to other articles of the law. Finally, the concept of "success" was involved in such discussions.

As for areas where it had formerly invested in exploration activities, the law did not guarantee they would be awarded to Petrobras. It had to apply for confirmation of rights and the contracts, in the latter case, were subject to a three year exploration phase. Such contracts, under the interpretation adopted, would not be subject to the extensions granted to other contracts, which would be executed after the Bidding Rounds subject to other applicable articles of the law.

C. Articles Pertaining to the Concession Agreement

Another important feature of the Petroleum Law as the option for the concession and the insertion of principles and articles that should be introduced in the concession agreement draft.

These provisions under Articles 43 and 44 (essential articles and the obligations of the concessionaire)[48] set forth the guidelines for the preparation of the first official draft[49] and gave rise to some discussion involving the best interpretation of the law.

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47. *See* Agência Nacional Do Petróleo, *at* http://www.anp.gov.br (last visited Jan. 17, 2001) [hereinafter ANP website]. Among these concession contracts, 115 were exploration, 51 were development and 231 were production.

48. Decreto No. 9478, *supra* note 11.

> Article 43—The concession agreement shall faithfully adopt the conditions of the call for tenders and of the winning tender, and shall have as essential articles:
>
> I. the definition of the block which is object of the concession;
> II. the duration of the Exploration phase and the conditions for its renewal;
> III. the work program and the estimated amount of investment;
> IV. the obligations of the concessionaire with regard to participation, as set forth in the Section VI;
> V. the indication of the guarantees to be given by the concessionaire with regard to the fulfillment of the contract, including the accomplishment of the investments as adjusted to each phase;
> VI. the specification of the rules regarding the returning and evacuation of the areas, including the removal of the equipment and installations, and the reversal of assets;
> VII. the procedures for accompanying and the exploration activities, development and production, and for the auditing of the agreement;
> VIII. the obligation of the concessionaire to provide to the ANP reports, a data and information relating to the activities being carried on;
> IX. the procedures related to the transfer of the contract, as established in the Article 29;
> X. the rules about controversy solutions, related to the contract and its performance, including conciliation and international arbitration;

1. General Features of the Concession Agreement

Some of the present features of the concession agreement are typical of most current exploration and production contracts around the world. It is hard to point out the evolution of the wording along with all the discussions that were held from 1997 on, but it is certain that some of the aspects that were subject to criticism at the earlier stages have been subject to improvements.

The overall duration is 36 years. The exploration phase can take up to nine years and can be extended under the conditions established in the agreement.[50] The production phase has a duration of 27 years starting from the moment of the commerciality declaration (*Declaração de comercialidade*), which also can be extended or terminated early by the concessionaire with prior notification of six months.

2. Concessionaire Rights

The concessionaire has exclusive drilling and production rights in the concession area. He also has the property of the hydrocarbons from the metering point on, owning the rights of commercialization. Another prerogative is the right to export, subject to the ANP's

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XI. the cases of termination and termination of the contract; and
XII. the penalties applicable in the case of default by the concessionaire of its contractual obligations.

The contract conditions for the renewal of the period of time for the exploration, referred to in item II of this article, shall be established in a way as to assure the return of a portion of the block, at the discretion of ANP, and the increase in the amount of the payment for the occupation of the area, according to what is established in the sole paragraph of Article 51.

Article 44—The contract shall establish that the concessionaire shall be obligated to:

I. to adopt in all of its operations the measures necessary for the conservation of the deposits and other natural resources, for the safety of personnel and equipment, and for the protection of the environment;
II. to communicate to the ANP, immediately, the discovery of petroleum, natural gas or other hydrocarbons, or other minerals;
III. to effect the evaluation of the discovery in the terms of the program sent to the ANP, present a report on the marketability and declare its interest in the development of the field;
IV. submit to the ANP the plan of development for the field which was declared commercial, containing the time schedule and the estimated investment;
V. to be liable for the acts of its agents; to save harmless and to indemnify for all and any damage resulting from the contracted activities of exploration, development, and production; to be required to reimburse ANP or the Federal Government for any burden they may bear as a consequence of possible demands motivated by acts that are of the responsibility of the concessionaire; and
VI. (to) adopt the best industry practices of the international oil industry and obey the relevant technical and scientific rules and procedures, including the ones referring to the appropriate recovery techniques aiming at the rationalization of production and the control of depletion of the reservoir.

49. Decreto No. 8987, *supra* note 38. Other very important principles to be adopted in the first draft were expressed under Articles 23 and 24, Contractual Phases; Article 28, Termination of Concession; Article 29, Assignment; Article 27, Unitization; and Article 43, Arbitration.

50. The first contracts executed with Petrobras have a shorter exploration period and have limited extension possibilities.

authorization.[51] The possibility of participation through joint ventures (*consórcios*) with joint and several liability is foreseen under the law and further specified in the Agreement.

3. Concessionaire Obligations

The concessionaire must be a Brazilian company, which can be controlled by a foreign company and, if the signatory is affiliated with another company that had been previously qualified, it has to present a performance guarantee. The concessionaire has the obligation to perform all of the operations undertaking the risks and costs of the activity, to accomplish the minimum exploratory program (PEM) (which should offer financial guarantee with the same value of the total estimated of the PEM), and to inform the ANP about the progress of the operations. The concessionaire shall be liable to the ANP, the Government and third parties for losses and damages resulting from the operations. It should also obtain appropriate insurance for the operations.

4. Sanctions and Penalties

In case of default, the administrative and pecuniary sanctions of the Brazilian legislation are applicable. There are hypotheses of early termination by the ANP in case of default or failure to remedy such default by the concessionaire.

5. General Information

As for the dispute resolution mechanism, the arbitration must be held in Rio de Janeiro, following the International Chamber of Commerce (ICC) rules, in Portuguese—but with the possibility of presenting witnesses and testimony in English.

The assignment of rights is subject to the approval of the ANP, and if the assignee is not a major company, the ANP can ask for performance guarantees.

D. Comments on the New Regime

The ANP has an ever-growing importance in the new legal framework, which introduced other regulatory agencies for the fields of energy and telecommunications, among others.[52]

The Agency was effectively organized only in 1998.[53] In a way, although of a lower hierarchical level, the Ministry Official Instruction (*Portaria*) that defined offices and positions within the hierarchical structure of the Agency really helped render effective and

51. This is a very important issue. *See* Official Instruction No. 7, de 11 de janeiro de 1999, D.O.U., 12.01.99.

52. The studies on the regulatory agencies stress the new survey and control role performed by the State. *See, e.g.,* Sérgio Manheimer, *Agências Estaduais Reguladoras de Serviços Públicos* [*State Regulatory Agencies of Public Services*], 343 REVISTA FORENSE JUDICIAL BULLETIN 221 (1998). Alexandre Santos de Aragao, *Os Ordenamentos Setoriais e as Agencias Reguladoras Independentes* [*The Regional Statutes and the Independent Regulatory Agencies], in* VI REVISTA DE DIREITO DA ASSOCIACAO DE PROCURADORES DO NOVO ESTADO DO RIO DE JANEIRO 87–136 (Lumen Iuris ed.).

53. *See* Decreto No. 2455, de 14 de janeiro de 1998, D.O.U., de 15.01.1998 [hereinafter Decreto No. 2455].

operative the day-to-day life of the administrative body. In these initial years, because they faced a legal deadline of August, 1998, the Agency was very active in receiving all data and information formerly kept by Petrobras itself and in taking up the management of all issues related to the downstream and upstream areas in Brazil, including the issuing of the Draft Concession Model; receiving of comments through the Internet; the selection and award of the areas to Petrobras selecting and awarding; and the execution of the first concession contracts with Petrobras. The Agency has rendered available, through the Internet, other drafts of regulations prior to establishing its definite terms, started to promote integration and regulatory changes in consultation with other administrative bodies, and started to organize the databank that will be accessible to the industry. The issuance of all the Official Instructions so far shows the level of regulatory activity performed by the ANP.

Another distinctive factor, at the level of overall policy to the oil industry, is the creation of the National Council for Energy Policy. This council, which is expected to have an important role in the new scenario faced by the Brazilian oil industry, has not yet set forth directives.[54]

It is also true that the oil companies focusing in Brazil have spent a long time scrutinizing the scenario, an analysis which depended on the amount which the government would be entitled and on other tax and policy definitions including export rights, remittance and exchange, and other issues relevant to investors. The years 1996 through 2000 have been very exciting times in Brazil, with the emergence of a big forum of discussion involving the relationship between the State and Petrobras, and the familiarization of the investors not only with the progressively issued new oil and gas legislation, but with impact of the presence of private companies in a legal environment adjusted to the presence of a single company for so long.[55]

In the context of the new measures taken by the Government, we can quote a series of complementary issues that have been taken care of as a result of the need for adjustment to the legal environment by the new investors. Many of these changes originated with the dialogues and questions posed in the Legal Technical and Tax Workshops promoted by the ANP.[56] Some of these issues involve other governmental entities, and the ANP has been playing its role trying to reach a compromise between all interests and concerns at stake.

IV. SOME KEY ISSUES FOR INVESTORS

A. Formation of a Brazilian Company

On the part of the investor the first aspect that should be noted is the requirement that the foreign company incorporates a company in Brazil, which will become the party to the concession agreement.

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54. Although the two main entities were already created under Decreto 9478, they were actually given shape through later Regulations: *Agência Nacional do Petróleo* [National Petroleum Agency] (ANP), Decreto No. 2455, *supra* note 53, and *Conselho Nacional de Política Energética* [National Energy Policy Council], Decreto No. 2457, de 14 de janeiro de 1998, D.O.U., de 15.01.1998.

55. The leading role performed by the Brazilian Petroleum Institute must be mentioned, because it enlarged its membership, now practically involving all oil and gas players. Its activities encompassed promotion of workshops, seminars, congresses, and discussion groups of all matters related to the oil industry at universities which already had oil and gas technical programs, in partnership with Petrobras or not.

56. *See generally* ANP website, *supra* note 46.

B. Government Take and General Tax Matters

The government take is defined under Article 45 of the Petroleum Law. The Agency has certainly played a role in the conceptual discussion involved in the parameters of the government take prior to its definition under Decree 2705.[57] This definition had been cautiously waited upon by all players in the industry, since only its combination with the present burden imposed to the companies in general in Brazil enabled a clearer picture of the overall expected rate of return of investments in Brazil.

The concession contract reproduced those parameters, adding to them the investment on research requirement explained above.

The Brazilian fiscal system encompasses various taxes generally applicable to companies, including federal, state, and municipal taxes. The description and comments on these would be beyond the scope of the present analysis.

In relation to the oil and gas industry, some adjustments have been made, like the changes in the temporary admission of goods and equipment (called *Repetro*), and other changes will need to be made to account for the introduction of players other than Petrobras. Strictly speaking of government take, Article 45 sets forth:

> The concession contract shall dispose on the following government participations, foreseen in the bidding announcement:
>
> I. signature bonus;
>
> II. royalties;
>
> III. special participation; and
>
> IV. fees for the occupation or retention of area.[58]

The signature bonus is payable in full prior to execution of the concession agreement. The "Edital" (Call for Tender) (an official publication used to call investors in order to dispute the signature of a concession agreement) establishes the main rules and conditions involved with the concession and sets the minimum bid amount. The minimum amount varies according to the Block classification.

The royalty is foreseen in Article 47 of the Petroleum Law. The rate established is of 10%, and may, in exceptional cases, be reduced to the minimum of 5%. Nowadays, the progressive royalty principle is under consideration, meaning there is an expectation that it might be reduced to the minimum rate allowed, in certain cases.

The criteria for deciding royalty rates are geological risks, production expectations, and other relevant factors such as market proximity, type of product, existing infrastructure, and difficulty of operations. Royalties apply to total volumes of oil and gas, measured at metering points defined in the development plan for the field, and include the amount consumed as fuel in field operations, lost before metering, authorized by the ANP but not included in exempt volumes, and flared without the ANP authorization.

The special participation, defined by Article 50, is payable quarterly on net income from fields that achieve substantial production volumes. No special participation is imposed until the expected volume is achieved and the cumulative net income is positive.

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57. Decreto No. 2705, de 3 de agosto de 1998, D.O.U., de 04.08.1998.
58. *Id.*

The gross revenue for a field is based on the same volumes and valuations used to calculate royalties, except that oil and gas volumes used in operations, lost before metering or flared, or not sold, are not included for purposes of a special participation.

The rental fees rates per square kilometer vary depending on the phase. Moreover, there are landowner fees, applicable only to onshore fields. The calculation of the amount to be paid is based on the total production value of wells located within the properties, valued in the same manner as royalties.

As for the fees applicable to the occupation or retention of areas, the Portaria 143/98 sets the rate at 1%, payable monthly, and requires the contract to be established between landowner and concessionaire.

A great concern on the part of all interested players is the overall impact of those new taxes added to the regular burden imposed on company activity in Brazil, but these general tax issues are beyond the scope of the present analysis.

C. Environmental Law

In Brazil, legislation concerned with the meticulous aspects of the environment—water and mineral resources, forests, cultural assets, etc.—has existed since the 1930s, although it was only in the 1980s that new laws were issued to embody the latest forms of environmental protection, established by the Stockholm Declaration of 1972.

Nowadays, in Brazil, there are many contending non-governmental organizations, a public attorney specializing in environmental issues, and a growing concern led by students and environmental law professionals.

Law 6938 dated 1981 established the National Environment Policy, by introducing the bases, boundaries, and means of the National Environment Policy. Moreover, it created a National Environment System integrated by federal, state, and municipal bodies, and conducted by Conselho Nacional do Meio Ambiente (CONAMA), the federal normative body.

Amidst the various and fundamental innovations of Law 6.938, it is worth mentioning the regime of strict liability—making it unnecessary to prove intent in order to impose liability—for environmental damages by any polluting party.

Concerning the petroleum industry, the relevant environmental legislation deals with environment licenses, which are mandatory for the development of the operations.

Article 10 of Law 6938 sets forth the licenses as a condition prior to activities using natural resources, considered to be effective or potentially polluting, or capable of causing environmental degradation.

The licenses are supposed to be granted in different stages during the implementation of a specific project. Therefore, at the beginning of each new stage, the appropriate authorization must be required.

The Instituto Brasileiro de Meio Ambiente e dos Recursos Renovaveis (IBAMA), which integrates the National Environment System, is the Federal Environmental Agency, the governmental institution competent to license the operations off-shore related to more than one state as well as the activities conducted in lands owned or submitted to the federal jurisdiction. Moreover, when the activities impact only on one state, the licenses must be given by the state environmental institution.

The petroleum operations require three types of licenses:

1) Previous License (*Licença Prévia*), which is mandatory for the activities of drilling and production tests.[59]

2) Installation License (*Licença de Instalação*), which is mandatory for the development activities for the new fields and for the installation of new equipment for fields that are already in production.[60]

3) Operation License (*Licença de Operação*), which is mandatory for seismic and production activities. An Environmental Study is required for seismic operations (*Estudo Ambiental* (EA)). The Environmental Study must be simple, used only to identify the environmental impacts. An important issue to be studied is the interference in fishing activities. The production operations require an Environmental Control Project (*Projeto de Controle Ambiental* (PCA)), which consists of the reports containing measures to minimize environmental impacts. Moreover, in order to avoid environmental damages, the reports required during the progress of the operations also have an environmental aspect, including the Development Plan and the Work and Budget Program.

Finally, it is worth mentioning the ANP's role in the protection of the oil and gas resources, as well as the environment and the safety conduct of the operations. Consequently, the ANP is trying to set forth jointly with IBAMA to develop regulations applicable to the activities conducted by the petroleum industry. A general Agreement has been executed between ANP and the Environmental Ministry last September aiming at creating an environmental agenda for the oil and gas industry.[61]

D. Preference for Brazilian Goods and Services

The Second Bidding Round reinforced the requirements and specified the criteria applicable to this preference, which is also a factor of evaluation of the bids.[62] The new concession draft model also brought a new wording on this issue. More recently, the ANP has rendered available on the internet a draft of a new regulation, which is still being subject to criticism by the industry, because it is thought its implementation as proposed would affect vested rights under concession agreements already in force.[63]

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59. The Previous License for Drilling (*Licença Prévia de Perfuração* (LPer)) requires an Environmental Control Report (*Relatório de Controle Ambiental* (RCA)), which must contain a detailed description of the activities to be developed; identification of the environmental risks and the effective impact caused by the activity; and appointment of the mitigation procedures.

The activities related to the extended production tests are temporary, but relevant in order to evaluate if the production of a reservoir or pool is economic. Previous License of Assessment of production (*Licença Prévia de Produção para Pesquisa* (LPpro)) requires the Environmental Viability Study (*Estudo de Viabilidade Ambiental* (EVA)), which must contain: a development Plan for production test or resources assessment, an environmental assessment, and the appointment of the controlling procedures to be taken.

60. Either the Environmental Impact Study and Report (*Estudo e Relatório de Impacto Ambiental* (EIA/RIMA)) for new fields or the Environment Assessment Report (*Relatório de Avaliação Ambiental* (RAA)) for productive fields is required. The EIA/RIMA shall contain a complete social and environmental report, as settled by the CONAMA Resolution 1/86. Moreover, there will be public audiences at the municipalities affected by the operations. The RAA consists of an environmental diagnostic, description of new activities, and the mitigation procedures.

For each one of these environmental reports, IBAMA gives a Term of Reference (*Termo de Referência*), containing the liabilities and limitations to be considered. The concessionaire is duly responsible for the execution and (for) the information of the report.

61. It is expected that this Agreement will allow funding of RS$75.7 million to improve environmental licensing activity. *See* BRASIL ENERGIA, Oct. 2000, at 40.

62. *See* ANP website, *supra* note 47. It is important to note the efforts made by a new entity, Organização Nacional da Indústria do Petróleo (ONIP), which paved the way for a larger amount of purchase at the Brazilian market. *See* BRASIL ENERGIA, July 2000, at 2, 4.

63. *See id*.

V. THE OPTION FOR THE CONCESSION: LEGAL AND CONCEPTUAL IMPLICATIONS

A. The Concession Law

The concession has undergone a revival in Brazil, in line with the privatization that is taking place in various areas of the economy.

In this context, the new Concession Law[64] has received a lot of attention from scholars and many investors have manifested their belief or their doubt as to the applicability of such law to oil and gas concessions.

As a matter of fact, Law 8987 stems from Article 175 of the Federal Constitution, which covers public services. According to the Brazilian doctrinal tradition, the three main so-called branches of the concession include the public services, the concession for public works, and the concession for economic exploration of public goods. They are different in nature, and the economic activity performed under oil and gas concessions does not fit well with the concession for public services.

B. Some Key Aspects Under the Law and the Concession Contract Draft

Few issues have raised such controversy as the standard of liability under the concession contract. The discussions within the legal subcommittee formed by the oil industry led to consultations with law professors, who treated the subject in legal opinions issued upon request to the Brazilian Petroleum Institute (IBP).[65]

Many scholars have been consulted and the question is still open for further discussion, although the wording of the contract remains unchanged. The discussion started with the concept of strict liability adopted in the draft concession contract.[66]

Two scholars have supported this view of the industry with different reasoning, leading to two separate conceptualizations. One of the scholars, Toshio Mukai, states that the denomination concession contract in Law 9478 does not correspond to its legal nature.[67] As inferred from Article 177 of the Federal Constitution, a denomination concession contract regulates an economic activity, whereas concession contracts as a general type regulate public services. Therefore, the oil and gas exploration and production contract is a private law contract different from concession instruments that are regulated by public law.

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64. Decreto No. 8987, *supra* note 38.

65. These legal opinions have circulated among members of the Institute, and one of them was already published in 2000. *See supra* note 67.

66. The concept was adopted by the wording of the following paragraphs:

> (2.2.1) For all legal action, appeal, demand or writ, injunction or order issued by a court, arbitration court, audit, inspection, investigation or dispute of any type whatsoever, as well as for any compensation, penalties, fines, or sanctions of any nature related to or deriving from such damages and losses.
>
> (21.2) Without adversely affecting the provisions of Paragraph 2.1.1 and in compliance with it, the Concessionaire will assume full, strict liability for all losses and damages to the environment and third parties resulting directly or indirectly from the Operations and the execution thereof, as well as the abandonment and removal and reversion of assets in terms of paragraphs 18.2 through 18.4.1, agreeing to repair such and pay compensation for the Federal Government and the ANP in terms of Paragraphs 2.2 and . . . .

67. Toshio Mukai, 25 REVISTA TRIMESTRAL DE DIREITO PUBLICO [QUARTERLY J. OF PUBLIC LAW] 82–93.

The other scholar, Maria Sylvia Zanella di Pietro, advocates the opinion that the oil and gas exploration and production contract is simply a different kind of concession contract, namely a public property use concession contract, according to Articles 20 and 176 of the Federal Constitution.[68]

The controversy is actually related to the classification of the concession for oil and gas in the Brazilian legal system, which should not the be the same as the concession for services. One can say there is still room for discussion around this principle, which is of vital importance to the industry.

VI. THE BRAZILIAN CONCESSION CONTRACT MODEL: EVOLUTION AND PERSPECTIVES

The basic hybrid approach of the first concession contract released by the ANP would allow us to say that it incorporated therein many features of other types of contracts in the industry. Some participants in the industry argued that it resembled more a risk service contract type or even in some aspects a production sharing agreement.

The fact is that it has undergone a series of reviews as from the First Bidding Round, trying to bridge into the gaps of understanding and interests of the various actors in the industry. The draft of the Second Bidding Round went through a detailed review both by the industry, through the suggestions of the legal committee of IBP, and the suggestions of some individual oil companies. Hopefully, the result may accomplish the convergence of interests necessary for a successful venture that meets both the needs and expectations of Brazil and the needs of the foreign investors.

VII. SURVEY OF THE PARTNERSHIP PROCESS

*A. The Brazilian Contractual Joint Ventures (*Consórcios*) in the New Scenario of the Oil Industry in Brazil*[69]

One of the most interesting and challenging questions posed by the opening of the Brazilian oil and gas industry is the understanding of the particular features of the joint ventures that may be formed within the framework of Brazilian legislation.

The new Petroleum Law foresees the participation of oil companies through *consórcios*, either in the bidding to be promoted by the National Petroleum Agency, through Articles 38 and 39 of the ANP, or in the possibility of Petrobras and its subsidiaries forming *consórcios* (under Articles 63 and 64), in respect of those areas where the state company may exert the rights of preference for a transition period, as established under Articles 32 and 33.

The fact that the Petroleum Law clearly indicates the possibility of participation by a group of companies through *consórcios* should be interpreted as applicable to those who are to become parties to the Concession Contract. It is implied that other forms of association permitted by Brazilian law are permitted, and the *consórcio* would not be in principle the only option. The prospective partners who prefer the contractual joint ventures to the equity joint ventures and who wish to become concessionaires should contemplate the formation of a *consórcio*.

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68. *See* Instituto Brasileiro de Petróleo e Gás, *at* http:/www.IBP.org.br. (last visited Jan. 17, 2001) (on file at Brazilian Petroleum Institute).

69. *See* Rosado, *Current Practice*, *supra* note 34, at 75 (providing a partial earlier version of these comments).

Many of the issues that are commonly raised between oil and gas joint ventures are practically unheard of in our legal environment, due to the technical and economic considerations that enabled its peculiar developments in those countries where oil and gas ventures flourished.[70] Although joint ventures are rather common in all fields in the Brazilian economy, the presence of oil companies in the upstream oil sector in Brazil shall certainly require some effort, not only on the part of the regulating authorities, but also from all parties concerned, aimed at the correct understanding and adaptation of certain international standard practices to our legal system according to the principles established by the new Petroleum Law.

The *consórcio* has existed in Brazil, in scattered legislation, since the 1960s, but its more encompassing outline was given through the so-called New Corporation Law.[71]

From the preliminary assessment there are a series of questions that might be pointed out: The first one deals with the liability of co-venturers. The 1976 Corporation Law took a liberal approach concerning such liability, since in Article 278, Section 2, it is clearly stated that joint and several liability is not taken for granted, a provision that generated a rather intense legal discussion among Brazilian experts.

The Petroleum Law takes the opposite approach in the sense that it foresees that the oil companies that apply to the bidding shall indicate a leader, "without prejudice to the joint and several liability of the other companies in the consortium."[72]

Another interesting point is the apparent incompatibility between the option for the Brazilian consortium and the provisions that North American companies usually like to insert in their joint operating agreements, denying the legal nature of the joint venture, partnership, or other aspects of their relationship. If common law jurisdictions tend to consider such an approach to be invalid, the trend is even stronger in Brazil, where the Corporation Law already foresees the *consórcio* as the local option for the contractual joint venture.

Finally, there are other questions that have been posed as to the proper insertion of the joint operating agreement within the Brazilian legal system. In case the companies choose the contractual joint venture and opt for the *consórcio*, there is an aspect of Brazilian law that worries those who are not familiar with our legal tradition: Parties must file the *consórcio* with the Registrar of Companies, as required by the Corporation Law and the Petroleum Law.

Brazil has supported the approach that the filing requirement does not apply to the joint operating agreement, which is viewed as an operational addendum to the *consórcio* agreement. The *consórcio* agreement, as filed, is a more general document which should comply with the requirements of the law and make public the basic aspects of the association.

Other practical issues have been raised in the course of the last few years, allowing a deeper insight of the accounting and fiscal aspects of the operation of the *consórcios* on the upstream.

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70. *See generally* JOINT VENTURES, *supra* note 10.

71. Decreto No. 6404, de 15 de dezembro de 1976, D.O.U., de 16.12.1976. As an amendment, the brand new Corporation Law does not modify any provisions of the former law with respect to the *consórcio*, which therefore remains in force. Decreto No. 9457, de 5 de maio de 1997, D.O.U., de 06.05.1997.

72. Decreto No. 9478, *supra* note 11, art. 38(II).

B. Survey of Partnerships Executed with Petrobras

The negotiation of the first Petrobras joint ventures, the so-called "First Portfolio," was based on acreage offered among areas where Petrobras applied for exploratory rights, according to the transition benefits acknowledged by the Petroleum Law, as explained above. Other areas were indicated by Petrobras as blue areas, where it chose to perform alone in the first place. It implied the discussion and prior knowledge of the tradition of the industry in foreign countries. For such purposes, it was very important to count on the experience of Braspetro abroad.[73]

Many adaptations were required, deriving from the fact that the first conversations were held in 1996 when neither the Petroleum Law nor the Decree, which would further define the government take, were in place. The expressed partnership process became, little by little, a negotiation framework with many adaptations like the replacement of a simple confidentiality between the companies with three documents: the Memorandum of Understanding (MOU), the Agreement for Technical Assessment (ATA), and the Minutes of Meeting (MOM). These accounted for the fact that the initial discussions did not have a clear picture of the legal, economic, and tax parameters that would be applicable to such deals.

The negotiations were a challenge because they involved many areas simultaneously, and few people were trained to accomplish the tasks involved. One aspect that remained pending for a while was a clearer notion of the official assignment procedures before the ANP, which, by definition, meant a problem for the drafting and insertion of parameters in the participation agreements that would perform the assignment of rights as between the prospective assignees, other oil companies, and the prospective assignor, Petrobras.

The other joint ventures to be negotiated by Petrobras shall not have such complex features, added to the fact that a more experienced team will be able to benefit from the prior learning curve in many aspects, including reciprocity conditions offered abroad, which allowed an increase in the acreage offered to Braspetro.

At the beginning of the process, Petrobras was awarded 115 blocks for exploration.[74] In 1999 it returned 28 blocks to the ANP, 26 in full and two partially. Of those original areas Petrobras maintained 89, and it acquired five more at the ANP's bidding auction. These figures do not include Petrobras blocks for production.

C. Contracts Executed in the First Bidding Round

The understanding of the whole picture can now be enriched by certain numbers and events that show the present situation in the perspective of recent history from 1997, when the understandings concerning Petrobas Portfolios started and the first Memorandum of Understandings were executed.

It is already possible to see the First Bid Round promoted by the National Petroleum Agency in perspective, and among the many evaluations and interviews on the matter, some highlight the fact that it was well received by the market, although it is always harder with the first one.

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73. Besides the author of this article, other professionals from negotiation and technical areas were assigned to this project, which created a department in charge of the direct administration of the E&P partnerships in coordination with the regional units.

74. *See* BRASIL ENERGIA, Apr. 2000, at 38.

In the First Bidding Round in 1999, a total of 21 bids were made on the twelve blocks awarded, from fourteen companies representing six countries, representing a total of RS$487 million (approximately U.S.$286 million). Eleven companies succeeded in winning at least one block, with signature bonuses totalling RS$321 million (approximately U.S.$189 million).[75]

D. Contracts Executed in the Second Bidding Round

The Second Bidding Round was considered even more successful than the First Among the 23 Blocks offered, 21 were granted. The Bonus totaled RS$468 million. Among the 16 winners there were eight new Operators.[76]

VIII. THE NEW REGULATORY FRAMEWORK AND RECENT DEVELOPMENTS

The year 1999 may be considered yet another turning point in Brazil. The opening up of industry got its real start. New opportunities were initially due to the Petrobras partnership program, since the state company had been maintaining understandings with many oil companies for many years, aimed at the farming out of some of its interests in various concession contracts executed with the National Petroleum Agency. There were launched in 1999. It is to be remembered that, although Petrobras had been allowed to keep certain blocks under a different legal background (Articles 31 to 34 of the Petroleum Law), the applicable concession contract was in many ways similar to that used for the Bidding Rounds.

During 1999, many legal issues that concerned the investors were thoroughly discussed by the industry. Among those issues, one can mention the controversy explained above, concerning the legal nature of the oil and gas exploration and production contracts.

The year 2000 meant further steps in this process, since the Workshops and Seminars promoted by ANP, Brazilian Petroleum Institute (IBP), and other entities helped pave the way for the further improvements in the Concession Agreement and the dialogue about Official Instructions prior to its final publication.

It is not yet advisable to give a picture of the overall regulatory process, since there are many important regulations under way. On the other hand, it would go beyond the scope of this paper and in-depth analysis of the major issues under each of the Instructions. Anyhow, among the many official instructions enacted by the National Petroleum Agency, one can highlight the following, because of either their legal relevance or their impact among the investors: Official Instruction 7, which states that oil export activity shall be conditioned on the ANP's authorization;[77] Official Instruction 10, which established the procedures to evaluate the special take due by concessionaires;[78] Official Instruction 85, which regulates the importation of fuel oil;[79] Official Instruction 174, which regulates bidding procedures;[80] Official Instruction 176, which approves the regulation for Abandonment of Wells.[81]

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75. *See* ANP website, *supra* note 47.

76. *See id*. (providing Director-General of ANP David Zylberstajn's presentation at the Third Round First Road Show in Rio de Janeiro).

77. Official Instruction 7, de 11 de janeiro de 1999, D.O.U., de 12.01.1999, *available at* ANP website, *supra* note 47.

78. Official Instruction 10, de 12 de janeiro de 1999, D.O.U., de 13.01.1999, *available at* ANP website, *supra* note 47.

79. Official Instruction 83, de 4 de maio de 1999, D.O.U., de 04.04.1999, *available at* ANP website, *supra* note 47.

During the year 2000, the pace of regulatory activity of the ANP increased, trying to meet the industry's expectations and need for clear and stable rules. We should mention: Official Instruction 9, which approves the technical regulation defining terms related to oil and gas reserves and sets up criteria and directives for appropriation of such reserves;[82] Official Instruction 14, which established procedures for reports of accidents and spills;[83] Official Instruction 90, which approves the technical Regulation of the Developmente Plan;[84] Official Instruction 100, which approves the technical regulation of annual production program;[85] Official Instruction 114, which regulates access to data and information about sedimentary Basins;[86] Official Instruction 115, which regulates free access to transportation pipelines;[87] Official Instruction 123, which establishes the technical regulation for the annual program and budget relating to survey and control;[88] Official Instruction 249, which approves the technical Regulation of Oil and Natural Gas Losses and Flaring[89] and Official Instruction 255,[90] relating to free access to river oil terminals; and Official Instruction 259 which approves the Technical Regulation of the Evaluation Plan of Oil and Natural Gas Discoveries.[91]

From all these Instructions, maybe one of the most controversial was the free access. According to the results of the first commission created to decide upon a conflict between companies relating to free access,[92] it caused some discomfort and complaints from interested parties, since it was the leading case. As for evaluation, the industry criticism pointed out excessive interference, on the part of ANP.

More recently, the draft relating to Brazilian Goods and services, available on the Internet for discussion, provoked criticism based on legal grounds, because it might interfere with vested rights under existing concession agreements.

Besides those issued by the ANP, one regulation worth mentioning is Resolution 2644 from the Brazilian Central Bank.[93] It thereby authorized oil and gas companies to operate with bank accounts in foreign currency. This resolution represents an important means of promoting foreign investments in the Brazilian oil and gas industry.

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80. Official Instruction 174, de 25 de outubro de 1999, D.O.U., de 26.10.1999, *available at* ANP website, *supra* note 47.

81. Official Instruction 176, de 27 de outubro de 1999, D.O.U., de 28.10.1999, *available at* ANP website, *supra* note 47.

82. Official Instruction 9, de 21 de janeiro de 2000, D.O.U., de 24.01.2000, *available at* ANP website, *supra* note 47.

83. Official Instruction 14, de 1 de fevereiro de 2000, D.O.U., de 02.02.2000, *available at* ANP website, *supra* note 47.

84. Official Instruction 90 , de 31 de maio de 2000, D.O.U., de 01.06.2000, *available at* ANP website, *supra* note 47.

85. Official Instruction 100, de 20 de junho de 2000, D.O.U., de 21.06.2000, *available at* ANP website, *supra* note 47.

86. Official Instruction 114, de 5 de julho de 2000, D.O.U., de 06.07.2000, *available at* ANP website, *supra* note 47.

87. Official Instruction 115, de 5 de julho de 2000, D.O.U., de 06.07.2000, *available at* ANP website, *supra* note 47.

88. Official Instruction 123, de 18 de julho de 2000, D.O.U., de 18.07.2000, *available at* ANP website, *supra* note 47.

89. Official Instruction 249, de 1 de novembro de 2000, D.O.U., de 08.11.2000, *available at* ANP website, *supra* note 47.

90. Official Instruction 255, de 16 de novembro de 2000, D.O.U., de 17.11.2000, *available at* ANP website, *supra* note 47.

91. Official Instruction 259, de 5 de dezembro de 2000, D.O.U., de 12.12.2000, *available at* ANP website, *supra* note 47.

92. Official Instruction 80, de 31 de maio de 2000, D.O.U., de 01.06.2000, *available at* ANP website, *supra* note 47.

93. Resolução No. 2644, Banco Central do Brazil [Central Bank of Brazil], de 10 septembro de 1999.

Worth mentioning is the setting forth of the structure and further detailing of the role of Conselho Nacional de Política Energética (CNPE)(National Council of Energy Policy), through Decree 3520, dated June 20, 2000.

IX. OTHER LEGAL CHALLENGES DERIVING FROM RECEPTION

Many legal matters captioned under the oil and gas law had never been studied nor discussed in Brazil, as we have stressed, since with the monopoly in force many issues deriving from the participation of private companies in an open market now under consideration were not at stake. Unitization, for instance, is a good example of how we have neither that conceptual framework nor the judicial precedents that shape those agreements in other countries where the industry has been open for decades.

We have tried to summarize the main stages of the development of the oil industry in Brazil. We have also attempted to focus the main issues that have been discussed along with the emergence of the new oil and gas legal environment in light of the Brazilian legal tradition.

We hope to have enabled better insight both to foreign companies that are now coming to Brazil as well as to professionals and students that share an interest in energy law. We have been committed to this effort at all levels,[94] trying always in the process of dialogue around the issues involved in the Petroleum Contract in general, most specifically with an oil and gas concession, as well as with other contracts that are usual in the international oil industry.

X. ISSUES FOR THE NEXT BIDDING ROUNDS

The results reached by Brazil in such a short timeframe may be considered outstanding. The picture today accounts for 35 concessionaires among, of which seven companies are of Brazilian origin. Among the 122 Explorations Blocks already awarded, there are 23 different operators. Among the 44 Production Areas, there are 241 Production Fields, from thirteen producing basins with five different operators.[95] The specialized press acknowledges that another important sign of change is the fact that from these exploration blocks, 20 are being operated without Petrobas' participation. That would mean, according to those commentators that 40% of the exploration areas held in Brazil now are not operated by Petrobas.[96]

Much is yet to be seen in the near future concerning the growth of the oil and gas industry in Brazil. In terms of adaptation and evolution of the terms of the concession contract, the latest developments show an ability to maintain a dialogue and a convergence of interests of the players involved.

The result of the First and Second Bidding Rounds and the interest manifested around the First Road Shows of the Third Bidding Round,[97] as well as the high attendance at seminars promoted by the industry or by the ANP, show Brazil as an attractive spot.

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94. The seminars coordinated in October 1999 by the author and other eminent active participants from the industry about regulatory aspects had 200 attendees and was sponsored by the Brazilian Petroleum Institute (IBP).

95. *See* ANP website, *supra* note 47 (reporting the Director-General's first presentation on the Third Bidding Round in Rio de Janeiro).

96. BRASIL ENERGIA, Oct. 2000, at 34–35.

97. According to the ANP, 53 blocks shall be offered; the official timetable foresees the final process to take place mid-2001. *See* ANP website, *supra* note 47, at *Brazil, Round 3*.

A lot has been done during the year 2000 concerning the tax and other aspects of operations.[98] The ANP has increased its staff, has opened other ways of cooperation with other governmental agencies, and is facing its challenges in the mid- and downstream side of the business.[99]

A lot has yet to be done and the legal community, both international and Brazilian, has a significant role to play in that process.

98. *See* Marilda Rosado de Sá Ribeiro, *Tax Aspects: Challenges Faced by the Brazilian Petroleum Industry: Some Leasons From the Recent Past*, BRASIL ENERGIA (English Version), Sept. 2000, at 67–68.

99. *See* ANP website, *supra* note 47 (reporting the Director-General's first presentation on the Third Bidding Round in Rio de Janeiro).