
OIL AND GAS: REGULATORY FRAMEWORK FOR EXPLOITATION AND ROYALTIES DIVISION

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Discussions regarding oil and natural gas have been recently put into a new perspective since the start of activities on the pre-salt platform which is located in the Brazilian exclusive economic zone, more precisely in waters bordering the states of São Paulo, Rio de Janeiro and Espírito Santo, especially when it comes to the draft of a new ruling of the matter. Given that, and in order to renew the regulation of the sector, published over 40 years ago, new rules for the extraction and marketing of oil and natural gas have been discussed and approved in the Houses of Congress.

Even though it is possible to visualize the existence of several legislative bills concerning this subject¹, there are basically two noteworthy issues, which toughened the discussion on which would be the appropriate rules to petroleum exploitation in Brazil, which are the following: (i) the need to adopt a new exploitation model for such activity in that area, and (ii) how would the payment of royalties² work and how would they be

shared between the States, Federal District and Municipalities.

With regards to the proposal of a new model to explore oil and gas, it is worth mentioning that the Brazilian oil is currently being researched, extracted and produced through public utility. In this model, widely used in areas where the risk is greater in the upstream phase³, the utility services company owns the property of the oil and natural gas discovered and extracted.

In this sense, as the risk of failure in the search for oil, perforation and extraction in the pre-salt area is extremely low, the Brazilian government intends to adopt a new model to explore such product, which would consist in sharing profits and responsibilities. This model is used mostly in countries with abundant oil reserves such as Saudi Arabia, Venezuela, Nigeria and Indonesia once that, as opposed to through public utility, it provides greater control of the oil to the government.

¹Legislative Bills regarding Oil & Gas: LB No. 4.290/08; LB No. 4.565/08; LB No. 5333/09; LB No. 5.334/09; LB No. 5.430/09; LB No. 5.621/09 e LB No. 5.938/09.

² According to the Legislative Bill No. 5.938-A/09, the *royalties* Will be defined as a financial compensation in consequence of the oil, gas and other fluid hydrocarbons mentioned in the art. 20, §1 of the Brazilian Constitution, being prohibited to add it up to the oil costs.

³*Upstream* is the denomination of the phase where the producers search and study natural reserves of oil and gas, and also in which the minerals are extracted. Midstream (transportation) and downstream (purchase and sell of the products in the market) are also phases of the oil and gas value chain.

This system also sets that the parties may share the oil obtained from the extraction and that the Government will be the owner of the premises and equipment used during the operation, after a certain period of time is elapsed.

In Brazil's case, the model would only be applied to the oil produced in the pre-salt platform.

However, as it involves such a valuable asset, the exploitation of pre-salt also starts another debate that goes even beyond the issue concerning the mere exploitation model: what are, in numbers, the real profits that such activity can provide? And, most importantly, who will benefit from such profits and royalties?

The initial proposal of the Brazilian government established the division of the royalties only in favor of states and municipalities that are producers and those that were directly affected by the production.

However, the Congress recently made a few amendments in the Legislative Bill No. 5938-A/09 (which discusses only the royalties matter), determining the adoption of an equal division of royalties between every Brazilian state and municipality. This decision is not final and can be changed or vetoed on the presidential review. If this scenario is not changed by the President, the states of Rio de Janeiro and Espírito Santo will bear estimate losses that may reach the sum of 10 billion dollars per year, depending on the volume of oil produced.

Therefore, the discussions will continue in the National Congress until the final decision regarding the royalties division is finally presented.

In this sense, Almeida Advogados will continue to monitor the discussion until its conclusion, with our specialized team of lawyers widely experienced in Energy, Oil and Gas matters, and which has already assisted many relevant companies to structure their operations concerning this sector in the last five years.

Thus, our professionals remain at your entire disposal in order to provide any clarification or assistance regarding the subject matter.