José Carlos Ribeiro Filho
(Coord.)

MANUAL ON PETROLEUM LAW IN BRAZIL

II VOLUME

Vieira Rezende Advogados

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Aknowlegments of the Coordinator

I would like to thank all the collaborators who helped me turn this dream into reality, accepting my invitation and writing outstanding chapters that are included in this second volume of the Prime. These dear collaborators have sacrificed their leisure time to do research and produce excellent works, which, I am sure, will be very useful for the Oil and Natural Gas industry, shedding light on topics that are currently under discussion and will be very much discussed in the coming years.

José Carlos Ribeiro Filho

Note from the Coordinator

Vieira Rezende is committed to the integration of its members and associates from all the areas of its portfolio of services offered to its clients, so that a constant atmosphere of harmony, mutual respect, study and efficiency may be maintained.

The release of the 1st volume of the Manual on Petroleum Law in Brazil in October of 2016 left a very positive balance as far as that is concerned, because during its preparation, members and associates from various areas collaborated in writing the chapters, engaging in a constant exchange of ideas and knowledge.

Also, but no less importantly, was the response from the Brazilian and international clientele, who greatly appreciated the topics selected and the way of approaching them in a simple and direct manner, making rapid, clear and accurate comprehension possible for complex routine matters of the oil industry.

It was no different with this 2nd volume, however, its scope has been expanded from O&G and Offshore and transformed into a collection of chapters, and divided into 7 Parts, also covering practical notions and real-life cases experienced in the areas of maritime and tax law, as well as topics relating to the production of natural gas and the generation of electrical energy and conflict resolution by means of mediation.

The choice of topics favored issues that are among the daily concerns of our industry and for which uncomplicated information to assist in making operational decisions cannot easily be found.

The Parts are divided into: New rules that have an impact on the O&G Sector; Purchase of O&G assets; O&G, Offshore and Environmental Themes; Tax Issues; Issues involving Offshore Units; Settlement of Disputes in the Petroleum Industry and Themes on Natural Gas and Electric Power Generation.

The new rules referred to above (Part I) have information about the Law of the State-Owned Companies, Local Content, Repetro and the termination of the Sole Operator System. These topics, except for the first one, have greatly assisted our Sector to recover as from 2017. As for the State-Owned Company Act, it comes almost 30 years late and at a time when this type of company is tending to fall into disuse for various reasons explained therein.

The purchase of O&G assets (Part II) is contemporary with the execution of the Petrobras divestment program. There is a great movement in the Sector with the uptake of the activity, the arrival of new players and new forms of contracting. In this context, the importance of good auditing is growing, as well as the responsibility of the administrators in these times of Car Wash (Brazilian corruption scandal also known as Lava Jato in Portuguese) which is assuming extraordinary relevance. The internal and external oversight of private and state-owned companies is focused on these things. Lastly, with regard to the financing of exploration and production, the use of reserve based lending is growing, as a way of helping to raise loans.

As for the issues of O&G, Offshore and the Environment (Part III), sensitive topics have been chosen at this time, such as the mature field farm-in and its challenges. Another issue of great relevance that needs to be well understood by all those who are active in our Industry is the role of the Federal Accounting Court, which recently excluded two areas from an ANP Round because it disagreed with the chosen regime, to which the Minister of Mines and Energy, the National Council for Energy Policy (CNPE) and, of course, the President of the Republic had already agreed. In the environmental part, 3 themes stand out: Licensing, Ballast Water and Strategic Environmental Assessment in the Process of Offering E&P Blocks, three indispensable topics due to the economic repercussion that non-compliance with the respective legislation can bring to the projects. Regarding Offshore, we felt it relevant to discuss the guarantees for the financing of offshore projects and bring a chapter addressing the challenges and limitations in the application of article 93 – item III of Law 8,213/1991 to petroleum operations.

As for tax issues (Part IV), the reader will find chapters dealing with the legal/tax system established for international and national waters and a very current issue that is the concept of input in the oil industry and its repercussions on IPI, ICMS, PIS and Cofins in the industry of our Sector. Finally, information on the structures adopted by the industry within an international tax context.

Then, the chapters, involving offshore units (Part V), provide very practical and useful information on arrests of vessels and on how the Brazilian Courts have dealt with the issue of the statutory period for cargo damage in maritime transport. Another issue that always arouses great interest, given its relevance, concerns the limits of Brazilian jurisdiction to litigate and judge conflicts arising from the International Maritime Industry in the light of the Brazilian Code of

Civil Procedure (CPC). This Part concludes with notes on the responsibility of ocean freight container carriers.

In Part VI the reader will receive news of a *new frontier* of the Science of Law, which has been revolutionizing the settlement of disputes and which are constantly growing in importance, which is Mediation.

Finally, due to the relevance assumed by Natural Gas in the energetic matrix of Brazil (VII), very much due to the resolutions coming out of the Paris Climate Change Conference, we felt it important to present a study on the integration between natural gas production and electric power generation, as well as a study on natural gas in Brazil.

Preface

When José Carlos Ribeiro Filho, our partner and senior consultant in the area of oil and gas, proposed the release of volume II of the Oil and Gas Primer, we thought that he had in mind filling in the gaps of the first volume with the remained to be analyzed on the subject.

It was more than this. A man of prolific ideas and one of the best minds in the area, in theory and in practice, JC (as he is more commonly known) foresaw the need not only to expand the work that he had coordinated, but also to revise it.

If Brazil is not for beginners, much less so, the area of Oil and Gas. Only someone with a deep knowledge and a holistic vision of the industry would be able to address the topic.

JC was a godsend to Vieira Rezende, having complete practical experience in the Oil and Gas sector, where various areas, such as regulatory, company, tax, litigation, labor, customs, among others, came to understand and serve the sector. The primer is a reflection of this experience.

They say that ancient Chinese sages used to consider the stability of the times the best environment for evolution of thought, besides being a fundamental ingredient for a balanced and happy life.

Hence, the crucible of the curse: *that you live in interesting times* is attributed to them.

Brazil has been hit head on by this *curse*.

Our greatest challenge is to transform these *interesting times* into fertile soil for the construction of a new and better country.

However, while that future does not come, nerve-racking days, full of uncertainty are an enormous challenge for those looking to secure contracts and investments.

Part of this challenge is faced in this primer, in innumerous essays that cover complex and current topics, seeking to bring objectivity and clarity to the reader, regardless of being an expert or novice.

Good reading!

Paulo Vieira

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PART I

NEW RULES THAT IMPACT THE O&G SECTOR

1. The state-owned companies act and its implications for the O&G industry

José Carlos Ribeiro Filho
Daniel Araújo

1.1 A brief history of state-owned companies

Banco do Brasil (1808) and Caixa Econômica Federal were the first state-owned companies created in Brazil.

In the 1940's, 50's and 60's, many state-owned companies were created, such as CSN (1941), CVRD (1942), Chesf (1945), BNDES and BNB (1952), Petrobras (1953), Furnas and RFFSA (1957), Cepal (1959), Embratel and Correios (1969) and Sepro (1970).

All these companies were governed by the respective laws of their creation and by their Articles of Incorporation and, secondarily, by the business corporations act under which they were formed at the time.

In the 1970s, with the rapid growth of the Brazilian economy, studies and discussions began for a new corporations' act to meet the needs of a stock market that was already taking shape at that time. This law came into force in 1976, as Law 6,404.

The State-owned companies actively participated in the aforementioned economic development and were used to boost sectors of the economy, which lacked private investment.

That was the heyday of state capitalism, the preferred economic model of the military regime, which was adapted to the economy of that time.

The Business Corporations Act from 1976 devoted a chapter to disciplining State-owned companies (arts. 235 to 242), in their relations with the private sector.

The authors of the Draft Bill, Alfredo Lamy Filho and José Luiz Bulhões Pedreira, in a letter with the explanatory statement addressed to the Minister of Finance, Mário Henrique Simonsen, justified the inclusion of the provisions as follows:

> "29 Capital-Mixed Company was the object of some general rules aimed, primarily, at protecting minorities without sacrificing its operation. It is a company of greater significance in the economic life of the Country, and the conciliation of the public interest that dictated its organization with the objective of making a profit, which inspires the private investor, requires norms that the Draft Bill – refraining from much innovation in the matter – limited to the minimum necessary."[1]

As for the Government side of mixed-capital companies, Decree 84,128, dated October 29, 1979, created the State-Owned Companies Control Office (Sest), as the central body of the subsystem for the control of resources and expenditures of state-owned companies, under the Federal Planning System. The Sest was part of the Structure of the Presidency of the Republic and was linked to the Planning Office (Seplan), which had ministry status.

Currently created by Decree nº 8,818, dated July 2016, the Office for Coordination and Governance of State-Owned Companies oversees companies in which the Federal Government directly or indirectly holds a majority of the voting capital stock, that is, government-owned companies, government-owned companies, their subsidiaries and controlled companies, and other companies called state-owned companies.

1.2 General considerations

Law 13,303, of June 30, 2016, has constitutional support in article 173, paragraph 1, which states:

> "The law shall establish the legal system of public companies, joint-stock companies and their subsidiary companies engaged in economic activities connected with the production or trading of goods, or rendering of services, providing upon:
> I – their social function and the forms of control by the State and by society;
> II – compliance with the specific legal system governing private companies, including civil, commercial, labor and tax rights and liabilities;

1 LAMY FILHO, Alfredo, S. Pedreira, José Luiz Bulhões. Reforma da S.A. e criação de valores mobiliários (Business Corporation Reform and creation of securities) (draft bill). Sindicato dos Bancos da Guanabara, RJ, 1945, p.27.

> III – bidding and contracting of works, services, purchases and disposal, with due regard for the principles of government services;
> IV – the establishment and operation of boards of directors and board of supervisors, with the participation of minority shareholders;
> V – the terms of office, performance appraisals, and the liability of administrators."

This law comes into existence 28 years after the enactment of the Federal Constitution (FC) and much as a result of the corruption scandals evidenced by the well-known Car Wash Operation (Operação Lava Jato, in Portuguese), which discovered real criminal organizations in the state-owned corporations, composed of politicians, businessmen and directors/employees, formed in order to exploit illicit and criminal advantages.

As a result, the law is overly concerned with compliance matters, detailing procedures, and making the administration more bureaucratic, matters that would be best disciplined by regulatory standards and by the articles of incorporation of the state-owned companies. In any case, they serve as a guide for administrators and their internal and external auditors, as will be seen below.

Thus, mixed-capital companies, although they continue to operate in the civilian environment, observing rules of private law in their dealings with third parties and facing strong competition, increasingly find themselves with their hands tied, and it is a difficult task to manage them with the decision-making speed that business requires.

The referred to law is the result of a sum of pre-existing legal and regulatory rules and focuses on the legal framework for mixed-capital companies from the point of view of the federal government.

Even though it is endowed with a legal status under private law, the mixed-capital company is an integral part of the indirect Public Authority and is therefore subject to all the strict rules of those who deal with public money. And in a balance between the public interest of the controlling shareholder and that of the private investor shareholder, the public interest prevails, even to the detriment of the company's profit.

Confirming this assertion, there is a chapter in the aforementioned law that deals with the social function of the public company and the mixed-capital company. Here a reflection, a parenthesis, to mention that the two types of state-owned companies should not have been treated symmetrically, because the

first has no private shareholders and the second has. Mixed-capital companies, before pursuing their profit, must serve the collective interest or the imperative of national security expressed in the instrument of legal authorization for their creation, which makes the task of administering them from the perspective of the efficiency of the private environment an almost impossible mission.

Petrobras, when it was created in the 1950's, came to exercise the monopoly of the activity to develop the Oil Sector in the country, until then non-existent. At that time there was no capital available for that and the state-owed company fulfilled its mission in an admirable way. Today, this sector is fully developed, with various big oil companies disputing the market on an equal standing with Petrobras.

Since then, the Brazilian economy has grown a lot and it is believed that, from a perspective of the future, this type of state-owned company will be less and less used among us to exploit a business in the civil environment, because compliance with all the legal obligations makes its administration very expensive and it does not possess the agility and flexibility necessary for business transactions. Also finding good managers who want to manage them with all the risks arising therefrom, will be increasingly difficult.

As we saw above, in Brazil in the 1940's, 1950's, 1960's and 1970's this legal institute was of enormous value in developing sectors of the economy in which no private investors were interested. Today, with our economy fully developed and, with the downfall of the administrations in the last 13 years, who were managing these companies, it is thought that the tendency will be for them to be privatized in the near future. A recent study by the Fundação Getulio Vargas (FGV) came to the conclusion that half of the 151 state-owned companies controlled by the Union could be passed on to the private sector. As an example of this situation, we can mention the case of Eletrobras, for which the Privatization Project is being prepared.

1.3 Highlights of the law of provisions applicable to mixed-capital companies, such as Petrobras

The mixed-capital company is governed by Law nº 13,303 of June 30, 2016, even though it may be participating in a consortium with other private companies, provided that it is the operator of the consortium (paragraph 5 of

article 1). It follows that, when not an operator, its presence does not adversely affect the consortium, which will be free from the framework of this Law. Obviously in this hypothesis, the mixed-capital company will have to render its accounts internally to the Government, in the form of the Law.

However, in the case of Petrobras, the application of Law 13,303/2016 does not occur unrestrictedly to all its contracting. This is because Decree 9,355/2018, article 1, paragraph 7, determined that:

> "the contracting of goods and services performed by the consortia operated by Petrobras will be subject to the private companies own regime, case in which, the bidding procedure and Law 13303/2016 do not apply, respected the public administration principles foreseen in the Constitution."

The referred to Law, in paragraph 3 of article 1 guaranteed the federal, state or local Executive Authorities, powers to determine standards of governance for its state-owned companies. This mechanism, a delegation of competence from the Legislative Branch to the Executive Branch at all three levels of government, denotes the legislator's concern to avoid at all costs the repetition of the facts determined by Car Wash Operation.

The Law also applies to the companies with a specific purpose, which may come to be created by the mixed-capital companies. Before, the common understanding was that these companies escaped the rigors of state control because they did not meet the requirements to be considered as state-owned. Now there is no further discussion.

This law details in paragraph 7 of article 1 a list of items that the mixed-capital company must pay attention to when participating in any company as a minority shareholder. It is a guide for its managers who act as the interface with the private company.

Paragraph 3 of article 2 releases the mixed-capital company from the legislative authorization for participation in the capital of another company, when it is the same arising from treasury management operations, award of shares in guarantee and participations authorized by the Board of Directors in line with the company's business plan.

Because it is a federal mixed-capital company controlled by the Federal Government, according to paragraph 1, of article 4, the latter has the duties

and responsibilities of the controlling shareholder established in the Brazilian Corporations Law and it must exercise control over the company, respecting the public interest that justified its creation.

This provision is very current in times of the Car Wash Operation, because Petrobras, for example, has been defending itself in lawsuits abroad, claiming to be the victim of its administrators, who have used their positions to enrich themselves based on bad business decisions for the company, in exchange for bribes.

However, so far, Petrobras has not sued the ex-administrators indicted in the Car Wash Operation, which it could have done, pursuant to article 159 of the Business Corporations Law that says: "it is the up to the company, after prior deliberation at the general meeting, to bring an action for civil liability against the officer for the losses caused to its property".

This type of company, in compliance with item I of article 8, must prepare an annual letter executed by the members of the Board of Directors, with the explanation of the commitments to achieve public policy objectives in response to the collective interest or that imperative to national security which justified its creation, with a clear definition of the resources to be used for this purpose, as well as the economic and financial impacts of the achievement of these objectives, measurable through objective indicators.

In addition, it must disclose the relevant information in a timely and up-to-date manner, especially that related to the activities developed, control structure, risk factors, economic and financial data, management comments on performance, corporate governance policies and practices and a description of the composition and remuneration of the administration.

These are new documents that will have to be widely disseminated and that have certainly greatly increased the bureaucratic work in the company, documents that are visibly intended for the internal and external control agencies that will have their normal work of auditing greatly reduced, since it was transferred to the administration of the state-owned company.

The mixed-capital company will have to adopt rules of structures and practices of risk management and internal control described in article 9 that covers administrators and employees.

It is true that, at every step, becoming aware of the obligations increases the certainty that mixed-capital companies do not lend themselves to competing with private sector companies that exploit the same activities, given the

amount of duplicate information that it will have to produce for its controlling shareholder, with lost time and increased costs.

The creation of the statutory committee in article 10 aims to verify the compliance of the process of nomination and evaluation of members to the Board of Directors and to the Audit Committee, with competence to assist the controlling shareholder in nominating such members. Certainly the provision aims to avoid the appointment of politicians to such positions, but in practice we do not see how it can be implemented, unless they are outsiders and have a fixed mandate, to ensure independence in their work.

The nature of the contracts entered into with state-owned companies as exploiters of economic activity has always been a point of discussion. Much of the legal doctrine attributed to these contracts a hybrid nature, applying the rules pertaining to the Government, as well as the whole set of rules of private law, which ended up causing some confusion at the time of application of the law.

Law 13,303/2016 resolved the uncertainty around the issue, determining[2] that the rules of private law as well as the provisions of the law apply to public contracts. Although they are contracts signed with the Government, these contracts are essentially private, since they are the result of the State's exploitation of economic activity.

As a practical consequence, we have the application of the Civil Code (Law 10406/2010), leading, for example, to the end of unilateral changes of contracts, as well as the changes must be consensual (art. 81 of Law 13,303/2016). Thus, to the extent that the supremacy of the public interest seems to weaken, the financial fragility of the private company when compared to the state entity is reduced, approaching the contractual equilibrium characteristic of private relations.

In the meantime, it can be seen that Law 13,303/2016 does not make provision, for example, for the case of unilateral termination of a contract by the state entity. As a result of this gap in the law, it can be said that it will be up to the judge to assess the parties rights on a case-by-case basis. Thus, it is understood that state-owned companies will need to follow the contract with greater rigor and reasonableness, since they will be subject to the arbitration of the courts.

2 "Article 68. The contracts referred to in this Law are governed by its clauses, by the provisions of this Law and by the precepts of private law."

In the specific case of Petrobras, it is worth noting that in view of the express revocation of articles 67 and 68 of Law 9,478/1997, which served as the basis for Petrobras' simplified contracting regime and for the Petrobras Contracting Manual (MPC), as well as Decree 2,745/1998 itself, in order to characterize the tacit revocation of the aforementioned Decree and MPC, Petrobras issued the Petrobras' Regulations on Bidding and Contracts (RLCP), in compliance with the new law.[3]

The Board of Directors of the company, in view of the provision of the Law in question and by the powers granted by article 71, paragraph 1, of Decree nº 8,945, of December 27, 2016, approved the said regulation, becoming effective on the date of its publication, January 15, 2018, producing effects in a progressive way, so that it remained valid throughout the national territory.

Paragraph 2 of article 226 of the Regulation makes it clear that the bidding procedures and contracting initiated or executed before its term, including any Amendments continue to be governed by the previous legislation.

It should also be clarified, however, that the use of the previous legislation for the bidding and contractual procedures had been exempted until the abovementioned internal regulations came into force (art. 91 of Law 13,303 of June 20, 2016 and Paragraph 1 of article 71 of Decree 8,945 of December 27, 2016).

The comparison between the rules of Decree 2,745 and the MPC in relation to those of the new law, regarding the steps for bidding and contracting, which will be studied in the next item, reveals that the possibility of the company making invitations has been eliminated. In the new law the event will be published through the Official Daily Gazette (DOU) or in a newspaper with large circulation.

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3 Law 13,303: "Article 40. Public companies and mixed-capital companies shall publish and maintain updated internal regulations for bids and contracts, compatible with the provisions of this Law, especially regarding:
I - glossary of technical expressions;
II - register of suppliers;
III - standard minutes of notices and contracts;
IV - tendering and direct contracting procedures;
V - processing of resources;
VI - formalization of contracts;
VII - management and supervision of contracts;
VIII - application of penalties;
IX - receipt of the object of the contract".

1.4 Comparison between the bidding and contracting rules of the bidding and contract regulations of Petrobras and the previous regime (Decree 2,745 and MPC)

1.4.1 Pre-qualification and registration

Since its publication, Law 13,303 has not yet produced a fully consolidated interpretation, which makes it difficult to formulate accurate and reliable assessments. When examining the law in question, we find that many of its provisions establish open concepts, leaving regulation to the companies themselves, through their internal regulations. However, other provisions of the law constitute binding acts of the Government, with no margin for liberality and discretion of the state-owned companies, such as pre-qualification and registration of suppliers for contracting goods and services, which refer to objective criteria for participation in public bidding.

In the simplified contracting regime introduced by D2745 there was already the Certificate of Registration and Classification, the CRCC, and the Simplified Registration Statement (DRS), issued by Petrobras to companies that supply goods and services that meet the criteria established by the corporation. However, in practice, Petrobras Units maintained the so-called *Vendor Lists*, which consisted of a list of suppliers, containing the registration of the respective materials and/or services offered that were of interest to these operating units, which sent invitations only to selected suppliers to compete according to requirement.

This mechanism was terminated with the arrival of L13,303/2016, which enshrined the principles of equality and publicity in determining free participation in state-owned company tenders. The CRCC and DRS were replaced by the Cadastral Register Certificate (CRC). In any case, the pre-qualification and the registration as provided for in Articles 64 and 65 of L13,303/2016 do not constitute, in principle, any obstacles or limitations to the principles informed, since the guarantee of participation in the bids does not depend on inclusion in such vendor lists.

The RLCP establishes, in its article 9, that Petrobras may promote subjective pre-qualification, to identify suppliers in conditions to meet requirements for a particular order; as well as objective pre-qualification, to identify assets that

meet Petrobras' technical and quality criteria. It is an auxiliary procedure prior to bidding, and can be used when the bidding has qualification requirements that require a more detailed technical analysis. Thus, the objective of the pre-qualification is to seek the administrative principle of efficiency, since the prior analysis of the technical requirements will result in making the bidding procedure more expeditious.

On the other hand, the purpose of the registration, provided for in article 22 *et seq*, of the RLCP, is the prior evaluation of the companies, which may be used for the prior qualification of those enrolled in future invitations to bid. For those enrolled, Petrobras will issue the Cadastral Registration Certificate (CRC), which may replace, in whole or in part, the documentation required to qualify for a particular bid, depending on the requirements of each bid.

It is worth mentioning that the absence of a CRC does not prevent participation in Petrobras' bids, provided that the bidder meets the bidding requirements. In addition, article 22, paragraph 3 of the RLCP, states that Petrobras may, at its own initiative, enroll a certain bidder in the registry, using the documentation submitted for qualification in the bid in question. Nevertheless, the bids may be restricted to prequalified companies, and for this purpose, a Notice of Bidding must be published in the Official Daily Gazette and on the Petronect portal.

Additionally, one of the positive aspects that the registration is expected to bring is the centralization and greater publicity of the performance evaluation of the companies that work with Petrobras, such performance being measured by objective criteria to be defined and which could lead to the alteration, suspension or cancellation of the supplier's registration with Petrobras. Previously, vendor assessment was restricted to the Performance Evaluation Report (BAD) and later, to the Vendor Performance Index (IDF), with no further data visibility.

1.4.2 Corruption Prevention Program (PPPC) and Degree of Integrity Risk (GRI)

The PPPC has existed since 2014, so there does not seem to be major innovations in this area. However, in the RLCP, the PPPC seems to be being used as a guideline for conducting the state corporation's business.

The rules for definition of the GRI are available on the Petrobras website, but the criteria are subjective. However, the controversial point remains the discussion about the impossibility of participating in bidding, due to the attribution of a high degree of integrity risk. Firstly, it should be noted that, strictly speaking, the suspension of participation in tenders is the most severe penalty of administrative law on the matter. Analogously, the suspension linked to the negative GRI rating has the same effect as the penalty in question.

In this sense, considering that Petrobras does not provide individualized reasons for the classification attributed to companies that supply goods and services, we conclude that such an impediment is abusive. This is because, besides it not being the state-owned corporation's role to judge the integrity of its suppliers, there is no opportunity for these companies to present their defense, since they are only able to rectify the information for Petrobras' analysis after 6 months.

On this, we must point out the difference between precautionary freezing and temporary suspension. In recent years, after the revelations of the Car Wash Operation, various companies were prevented from participating in bids for an indeterminate time. In this case, it is a precautionary freezing, which is based on the law on administrative procedures (L9,784/1999, article 45[4]), for which there is no defined time limit, applied in situations of alleged imminent risk. The temporary suspension, originally provided in L8,666/1993 and replicated in article 206, III, of the RLCP, is applied as a sanction to a non-compliance of the supplier company, with a limit of 2 years.

1.4.3 Bidding

In general terms, L13,303/2016 to a certain extent sought to modernize the provisions on the matter set out in L8,666, aligning the rules determined in the Differentiated Regime of Public Procurement (RDC) (established by Law 12,462/2011), so that both regimes might provide for the inversion of phases (bidder qualification at the end of the contest, after judgment of the best proposal), open and closed dispute modes, as well as the possibility of appeal only at the end of the bidding process.

4 "Article 45. In case of imminent risk, the Government may reasonably take precautionary measures without the prior manifestation of the interested party."

Despite the advance that L13,303/2016 appears to represent in the bidding process for state-owned companies, the preliminary effect was negative for Petrobras, since the Simplified Regime previously in force gave the Administrator greater freedom, in addition to making the process faster and less bureaucratic than the current one. In addition, from a formal point of view, Petrobras' new contracting system presents a greater number of procedures to be followed by Petrobras, which, to a certain extent, has made the state corporation's bureaucratic apparatus less flexible.

The new legal statute determines, in article 42, paragraph 4, that in the case of bidding for engineering works and services, companies should use semi-integrated contracting, which consists of the elaboration and development of the executive project, execution of works and services, pre-operation, as well as other operations necessary and sufficient for the final delivery of the object of the contract. In this sense, Turn-Key contracting (EPCI), which is standardized under the D2745 system, becomes an exception and technical justification for using this contracting model must be presented.

Law 13,303/2016 determines that auction should preferably be the bidding modality to be chosen, according to the rule established in Law 10,520/2002. In dealing with the definition of the type of bidding to be adopted in this way, the legislator left room for regulation of the state-owned companies themselves, since the preferential character cannot be understood as an obligation.

In this way, the RLCP defined, in its article 46, the following types of bidding: I - auctions; II - open dispute mode; III - closed dispute mode; IV - combined dispute mode. The criteria for selecting the best proposal may be chosen from: I) lowest price; II) greatest discount; III) better combination of technique and price; IV) best technique; V) better artistic content; VI) highest price offer; VII) greater economic return; and VIII) better disposal of alienated assets.

Another highlight that draws attention to the regime introduced by the RLCP and the new law is that contracts cannot have a term of validity greater than 5 years, including in this limit possible amendments.[5]Exceptions to this rule are the projects contemplated in the Petrobras' business and investment plan, as well as when contracting for more than 5 years is market

5 "Article 137. The total term of the contracts may not exceed 5 (five) years, counted from the date of their execution, including any Amendments for extension, except for the exceptions of Art. 71, of Law nº 13,303."

practice. In the case of the aforementioned exceptions, it will be necessary to present a justification, which should be appended in the procedure for making the contract.

There is also the creation of a new type of direct contracting, in which the inapplicability of bidding is observed (art. 28, § 3 of L13,303/2016). The marketing and providing of services, when carried out by the state entity itself, related to the execution of the corporate purpose, do not need to be tendered. The law also mentions the choice of partners, in cases of business opportunity.

Also noteworthy is the change in the limit for small value contracting (art. 29, I and II of L13,303/2016) According to the new law, the limits are now 100,000 reais for engineering works and services and 50,000 reais for other services and purchases.

In addition, it is important to highlight the change in the Petrobras Supply Conditions (CFM), a document amended in 2018, which consists of a guide to general conditions for the supply of goods and services. As the main alteration, the liability of the supplier for damages caused to Petrobras and third parties is outstanding, regardless of intent or fault, pursuant to article 76 of L13,303/2016.[6]

Although the conditions set forth in this document may be modified in accordance with the provisions of the tender notice and contract, the CFM grows in importance in contracting situations in which the bidding document and contract do not establish specific legal and commercial conditions, referring to the CFM.

Finally, we have the replication of the figure of the Manifestation of Private Interest (art. 31, § 4 of L13,303/2016), which in essence was already practiced in the relationship of individuals with the Government. The state-owned company may call upon private individuals to prepare proposals and projects for enterprises.

It is worth mentioning that in practice, companies already used to present projects (design, research, etc.) to Petrobras at their own initiative, without, however, receiving anything in return. With this new instrument, the opportunity arises for companies to be remunerated for what they have always done without being able to pass on costs to Petrobras.

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6 "Article 76. The contractor is obliged to repair, correct, remove, rebuild or replace, at its own expense, in whole or in part, the object of the contract in which there are defects or errors resulting from the execution or materials employed, and will be liable for damages caused directly to third parties or to the public company or mixed-capital company, regardless of the corroboration of their guilt or deceit in the performance of the contract."

2. The new rules about local content

Tiago Vasconcelos Severini
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2.1. Introduction

With the advent of the Petroleum Law of 1997, that relaxed the monopoly on oil and gas exploration and production activities in order to implement the concession agreement scheme in the Country, new players entered the Sector and Petrobras lost its monopoly prerogatives, coming to have equal rights and obligations with the new concessionaires.

This movement in the Sector revealed the lack of preparation of Brazilian industry to meet the new demand for the supply of goods and services, which needed to be imported from countries with greater experience of working in these areas.

In light of this scenario, and having in view the intention to take advantage of the growing demand arising from oil and gas exploration and production activities, to drive the development of the Brazilian goods and services industry – highlighting the attempt to recover the shipping sector – Brazilian authorities decided to adopt, for the first concession agreements executed in the so-called Zero Round, certain clauses to guarantee the local acquisition of goods and services supplied by Brazilian industry (*local content clauses*).

2.2. Historic evolution

As from the 1st Bidding Round, which took place in June, 1999, the National Petroleum, Natural Gas and Biofuels Agency (ANP) aimed at stimulating the contracting of Brazilian industry and stipulated the indication of a percentage of local content by the companies participating in the bidding process, as one of the criteria for judging the proposals.

In 2003, with the oil segment increasingly strong in the Brazilian Economy and under the argument of representing a job creation factor and generation of foreign currency factor, the Government decided, through the National Energy Policy Council (CNPE), to publish Resolution nº 8, released on July 21 of that year, determining that ANP should establish a minimum percentage of local content for the supply of goods and services in the oil and natural gas exploration and production activities.

Due to the abovementioned Resolution, the advertisement for bids, as from the 5th Round, provided of a minimum percentage of local content that should be used by the concessionaires.

Thus, the percentages of local content indicated in the tenders submitted in the bidding processes, should at least meet the minimum value, and, in addition, the portion of local content offered by bidders exceeding the minimum value, consisted of a criterion of assessment of the proposals.

It should be noted that this protectionist movement, introduced by the local content policy, is grounded on article 219 of the Federal Constitution (CF), which states that the domestic market is a part of the national patrimony and, as a policy rule, determines that it should be promoted to make possible cultural and socio-economic development, the well-being of the population and the technological autonomy of the Country.

It is worth mentioning that, when the local content policy was initiated, it was analyzed as potentially violating international agreements in the sphere of the World Trade Organization (WTO), to the extent that it favors the national product in detriment to imported ones.

That approach resulted of the fact that the General Agreement on Tariffs and Trade (GATT), which was signed by Brazil, provides, as one of its main principals, the principle of non-discrimination between national and imported products of another signatory State.

However, the implementation of a local content policy, particularly for the oil and gas Sector, is not a Brazilian innovation, having already been adopted by other countries, also including signatories of the GATT Agreement, as it is the case of Norway.

In view of these circumstances, and despite the apparent violation of the GATT Agreement, the Brazilian local content policy – perhaps because of its use in other countries too, perhaps because of the difficulties in measuring its effective impacts on imported products – did not come to be

attacked directly by means of formal challenges initiated by other signatory States in the sphere of the WTO.

At the same time, however, it has been mentioned indirectly, in different challenges, as a measure that, together with other subsidies and incentives for local production, ended up causing damage to imported products.

In parallel with the implementation of this policy, in 2003, within the jurisdiction of the Ministry of Mines and Energy (MME), it was created the Program for the Mobilization of the National Petroleum and Natural Gas Industry (Prominp), with the intention of facilitating the increased share of the Brazilian goods and services industry in the Sector.

Given the requirement, in the concession agreements, of a minimum percentage for local acquisition of goods and services, in July, 2004, Prominp prepared, based on the methodology of funding of goods of the Brazilian Bank of Economic and Social Development (BNDES), a methodology for calculating the index of local content of goods, systems and services related to the oil and natural gas industry, which was denominated the Local Content Primer (Primer).

The Primer came to be applied as from the 7th Round, and a further innovation was included in the concession agreements: establishing that the commitments of the concessionaires relating to the local acquisition of goods and services should be proven to the ANP, which would be responsible for regulating the form of certification of local content.

Until the 6th Round, the commitments of local content – initially informed freely by the bidders, and then fixed mandatorily at levels equivalent to or greater than the minimum percentage – were not subject to clear and regulated criteria of measurement, which only came to exist as from the 7th Round, with the institution of all the rules relating to the certification of local content.

It is, therefore, from the 7th Round, that the local content policy acquires autonomous legal discipline, coming to face various interpretative conflicts, and bringing a significant impact upon the contractual relationships established among the concessionaires – committed to the percentages reported at the time of the due bidding process – and their suppliers of goods and services.

The impacts on the contractual relationships between oil companies and its suppliers resulted of the adopted practice of assigning the local content commitments, assumed by the concessionaires with the ANP, to their contractors. As a result of that practice, even though ANP, from a regulatory

perspective, could only challenge the certification of the local content of the concessionaire, any penalty occasionally applied triggers a corresponding obligation in the contracts signed by the oil company with its suppliers/services providers, meaning that the certification of local content became a concern and obligation of the entire supply chain of the oil and gas industry.

To fulfill the mission of regulating the certification of the local content, in 2007, ANP published the Resolution nº 36, which was responsible for the setting of criteria and procedures for the certification of local content in relation to goods, goods for temporary use, services, sub-systems, systems and assemblies.

This Resolution was later revoked, making way for ANP Resolution nº 19/2013, which is currently in force, regulating the local content clause included in the Concession Agreements established between the ANP and the concessionaires as from 2005, in the Transfer of Rights Agreement and the Production Sharing Agreements, disciplining the form of measurement and certification of local content of the referred contracts and presenting, as Attachment I, the Local Content Certificate Template and as Attachment II, the Local Content Primer.

2.3. Current system for the verification of local content

The measurement and certification of the local content needs to be verified, in compliance with Resolution nº 19/2013, in relation to each product or service acquired by the signatory of the Concession, Transfer of Rights or Sharing Agreement, to demonstrate the due fulfillment of the commitment assumed regarding the percentage of local content specific to that agreement.

If the commitment is not fulfilled, the company is subject to a fine by the ANP, in an amount corresponding to the percentage of local content set out in the commitment and not attained.

Because of this risk of a fine, the concessionaires, assignees or contractors of the production sharing system assign the assumed local content commitments to their contractors (service providers or suppliers of goods), and include provisions in the corresponding contract, that authorize the imposition of contractual fines to the contractors, in case regulatory fines are imposed by ANP to the oil companies.

In view of this practice, although the local content commitment is only assumed by the concessionaire, assignee or signatory of the sharing agreement with the ANP, it ends up being contractually passed on to the whole supply chain. Hence, the significant relevance of the matter for the whole Oil and Gas Sector.

In brief, the system for the implementation of the local content policy should be summarized as it follows: (i) the concessionaire, assignee or signatory of the production sharing agreement assumes a commitment of local content at the time of the bidding process or the signing of the contract with the ANP; (ii) then, it proportionately assigns the referred commitment on to each one of its contractors for the supply of goods or the provision of services; (iii) each one of these contractors (directly or indirectly) contracts a certifying company so that this might verify the local content practiced in the respective contractual scope; (iv) each one of these contractors delivers to the contracting companies, together with the contracted product or service, a local content certificate or corroboratory documentation of the origin, when the certification is waived; (v) agreement gathers together all the certificates and documents received from the different contractors and delivers them, together with any certificates that it itself may hold, resulting from products that it itself has manufactured, to the certification company it has contracted, which then performs the verification of the fulfillment of the commitment of local content assumed by it with the ANP; and (vi) finally, all the work of certification performed by the certification company of the concessionaire, assignee or signatory of the production sharing agreement is audited by the ANP, closing the cycle.

2.4. Critical analysis

In practice, the system described above is subject to a series of variables, such as the waiver mechanism – which consists of an exemption by the ANP of the fulfillment of a certain commitment of local content in relation to a specific product or service, through the due proof of commercial, technical or operational impossibility or infeasibility of acquiring certain goods and services in Brazil – or the price variations of products and services between the date on which the commitments were assumed and the moment at which they need to be fulfilled, during the outworking of the execution of the contract, which ends

up distorting the comparison between the percentages of local content set out in the commitments and those effectively reached.

Furthermore, the interpretive conflicts that arise from the analysis and application of the Resolutions published by the ANP are recurring, and consequently, the doubts of the companies, the contractual disputes resulting from different interpretations adopted by each party to the contract, the differences of understandings between the certification agencies themselves and, even, the absence of a consolidated position on the part of the ANP itself are common.

In view of this context, it is important to establish a distinction between the criticisms against the local content policy and the problems relating to the local content rules.

With regard to the policy, there is a discussion, for example, about the pertinence of the protective rules in the context of the Sector in Brazil, and about whether the amplitude of the policy should have more detailed characteristics, with the opening up also of each kind of goods and services, such as has been occurring, or more concentrated on the main focuses of incentive to Brazilian industrial development, as consubstantiated in the most recent guidelines from the CNPE, by means of fixed overall minimum percentages per segment.

On the other hand, with regard to the rules, the need for legal security is to the main concern, in the sense that any amendments in the local content legislation should generate effects only on future contracts, and not, as currently occurs, with immediate application also to the contracts already made and which are in course, even in the cases where the changes implemented entail greater onerousness. The suggested restriction of the effects of possible amendments in the regulation should be of great value to reduce the contractual disputes that result from the interpretative doubts about the application of the rules published by the ANP.

In this context, the change of treatment given to various goods, because of the revoking of Resolution 36/07 by Resolution 19/13 is emblematic.

The former one segregated the concept of goods, liable to certification – which involves the detailing of all its productive process, for analysis, and corresponding measurement of the corresponding amounts, of the national origin or not of each one of the inputs and components of the manufactured goods – that of materials – which depended only on the proof of origin to have their value fully considered as local content – based on the tax classification

(code in the Common Nomenclature of Mercosul – NCM) of the item under analysis. Thus, under the validity of Resolution 36/07, it was sufficient to verify the tax classification of the item, to get to the conclusion on the way its local content would be verified.

Differently, Resolution 19/13 created completely different concepts of goods and material, changing the mechanism based on the tax classification. The difference between these concepts started to be based on the existence or not of an express provision in the tables of commitments of local content attached to the Concession, Transfer of Rights and Production Sharing Agreements, or in the items and sub-items referring to the contractual commitments of local content.

Thus, the items qualified as goods based on the new Resolution, therefore being subject to certification, are all the items specifically described in the contractual commitments of the Concession, Transfer of Rights and Production Sharing Agreements, while the materials (verified based on the proof of origin and exempt from certification)now compose a residual concept (those items that are not goods).

This modification about the re-qualification of various items – which, based on the tax classification would be classified in one way, but which, due to the new concepts, came to assume another nature – affected the corresponding percentage of local content linked to each one of them and generated a series of conflicts among companies, certification agencies and the ANP.

The ANP was consulted on the topic and, after much discussion – which revealed divergent opinions inside the Local Content Coordination Office itself – it ended up deciding on a new normative modification, which instituted a mixed treatment for certain categories of materials, which came to be subject to the certification procedures, as if they were goods.

The situation described above revealed the need for a greater legal maturation of the regulations and application of the local content policy, a context in which we highlight, by way of example: (a) the relevance that there be created and regulated by the ANP an institutional mechanism of consultations, with the due provision of the effects thereof on the companies that make the consultation, and whose responses are made public for all those interested (in the molds of the consultations about the interpretation of the tax legislation and of the consultations about the tax classification of merchandise and services, existing in the sphere of the Federal Revenue Service); and (b) the authorization by the

ANP that the certification agencies use mechanisms and instruments already consolidated in other areas (such as information about the value, nature of the operation, CFOP, CST, origin of the product, etc., listed in the tax documents), to avoid divergent treatment or the overlapping of formal obligations with objectives equivalent to the obligations already existing and legally provided for.

Besides the above, there are also certain limitations in scope of the local content rules – which results in not being able to verify the totality of the goods manufactured in Brazil and of the service provided here – which shows an incongruence with the local content policy itself, the nature of which is of a general scope.

The goods manufactured in Brazil that may be classified as materials and that, once completed, may be sent abroad for integration into certain goods or system that later returns to Brazil to be used in oil and natural gas exploration and production activities fit into the limitation referred to above. Except for the items with these characteristics that were dealt with by Resolution 12/2016, which amended Resolution 19/2013, all the others continue not being computed for purposes of local content.

Therefore, the treatment of the items, for local content purposes, ends up being impacted, in such a situation, depends of the contractual format established for the supply, so that a same item may or may not have its local content computed as it may be supplied directly in Brazilian territory to the concessionaire, or it may be exported for an intermediate stage, before returning to Brazil and to be delivered to the final client.

Still in this context, it should be highlighted that the contractual structures adopted in the oil and gas Sector in Brazil are eminently influenced by the applicable special customs schemes, especially Repetro.

Therefore, it does not seem coherent that the form of structing the operations ends up affecting the local context verified, when the defining element should be, definitively, the place of manufacture of the goods or the rendering of the service.

2.5. Recent innovations and a new horizon

Precisely because of the incongruences referred to above, and with the intention of filling in the gaps left by the local content rules up to then in force, Decree 8,637 was published on 01.15.2016, which instituted the

Incentive Program for the Competitiveness of the Productive Chain, and the Development and Improvement of Suppliers of the Petroleum and Natural Gas Sector (Pedefor).

Essentially, Pedefor has two new mechanisms related to local content policy: (i) the provision of the creation of weights for certain investments, considered strategic and that involve engineering developed locally, technological development and innovation carried out in the Country, elevated potential for the generation of qualified jobs; and promotion of exports; and (ii) the institution of a bonus, to be calculated under the form and Local Content Units (UCL) – assessed in relation to the making of contracts for the purchase of goods, services and systems that may make possible the introduction of new suppliers in the Country, direct investment in the expansion of the productive capacity of suppliers, direct investment in the process of technological innovation of suppliers, purchase of goods and systems in the Country, with local content, to service operations abroad, and acquisition of pioneering batches of goods and systems developed in the Country – and which may be deducted from the local content commitment, to ensure its fulfillment or mitigate the impact of any non-fulfillment.

The Decree instituting Pedefor provides only general directives of the mechanisms described, so that the effective implementation, application and combination of such to the other rules already in force depend upon a more detailed regulation, which has been proposed at a really slow pace by the Steering Committee, composed of the Office of the President of the Republic, Ministry of Finance, Ministry of Development, Industry and Foreign Trade, Ministry of Mines and Energy, Ministry of Science, Technology and Innovation, National Petroleum, Natural Gas and Biofuels Agency, National Bank of Economic and Social Development (BNDES), and Funding Authority for Studies and Projects (Finep).

It should be explained, however, that the new rules, that have been published gradually, over the last 2 (two) years, have started from a broader approach, since they concentrate on the regulation of the parameters defined by the CNPE under the normative framework in force.

In other words, outstanding among the normative innovations is the setting of minimum percentages at lower levels than those that had been practiced, combined with the verification of the local content percentage based on large groups representing each segment, in place of the exhaustive detailing related to each good or service – which can be applied both to new rounds as well

as by demand of the interested companies, to old contracts (relating to the Concession Agreements of the 7th to the 13th rounds, and to the Assignment of Rights Agreements of the 1st and 2nd round) – and the strengthening of the effectiveness of the waiver mechanism.

In this sense, even though well-intentioned, the new rules end up representing a new start in the local content policy itself, instead of inserting it in a context of improvement of the rules under a more technical perspective.

Thus, instead of filling in the normative gaps behind the scenario of legal uncertainty, the recent innovations ended up by profoundly reducing the weight of the protectionist nature involved in the local content policy, through the relaxing of the conditions for the fulfillment of the local content requirements.

The effect, up to here, is quite positive for the oil and natural gas sector, and above all for its attractiveness both for the companies already participating in the Brazilian market, as well as new companies interested in entering the Brazilian market – especially at the moment of uptake after years of crisis – to the extent that the innovations introduced make possible a reduction of costs and liability associated with the *Brazil Risk*.

However, the way in which such innovations have been implemented, or proposed – since a large portion of them was established as a directive and is still pending regulation – has been generating strong reactions from entities representing the chain of local sub-suppliers, which raises concern about the soundness and lasting effect of the new rules, and mainly, from the new viewpoint adopted for the local content policy.

3. The new Repetro

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Paloma Amorim

3.1. Introduction

Among various amendments introduced into the legislation applicable to the Brazilian oil and gas industry, as a result of the recent publication of Law 11,358/2017, Normative Instructions 1,781/2017, 1,796/2018 and 1,802/2018, and ICMS Agreement 03/18, besides the corresponding State Decrees and Laws that internalized the rules set out in the referred Agreement, three types of modifications stand out: (a) the modifications referring to the structure of the regime, with the new possibility of importing goods permanently (with transfer of ownership to the Brazilian entity) or acquiring them locally by a company domiciled in Brazil; (b) the modifications relating to the applicable procedures and to the routine of operationalization of the regime; and (c) the modifications relating to the requirements and conditions for application of the regime, or for the full fruition of the corresponding tax treatment.

In view of such a situation, it must be pointed out that various modifications introduced by the succession of new rules related to Repetro cause relevant impacts to the contractual models typically practiced in different segments of the industry, which will need to be reviewed and discussed among the parties involved, either for maximization of the benefit obtained from the favorable tax treatment, in certain cases, or for mitigation of the inevitable financial impact to be generated under other circumstances.

The first group of modifications involves the expansion of Repetro, with the creation of the possibility of achieving operations involving the acquisition of the ownership of the goods by the beneficiary company in Brazil, which now can be performed with the benefit of the suspension of federal taxes, which later is converted into exemption.

According to the new legislation, two lists were created (Attachments I and II of IN 1,781/2017) referring to the goods subject to Repetro-Sped, one indicating the temporary goods, and another, the permanent goods. Besides the goods specifically listed, just the apparatus, parts and items to be directly incorporated into the listed goods, and the tools used directly in the maintenance of the listed goods can be submitted to Repetro-Sped.

To the temporary goods, both modalities are applicable: the temporary importation mode, which follows the same mechanism of the *old* Repetro – where the ownership of the goods is held by the company domiciled abroad, and its possession is transferred based on a charter party, hire, lease, loan for use agreement, etc., to the company domiciled in Brazil, and that will use it in oil and gas activities in Brazil; as well as the new mode of definitive importation, by choice of the importer and beneficiary.

However, to the permanent goods, the new modality of permanent importation is the only one applicable, It involves the acquisition of the ownership of the goods by the beneficiary company domiciled in Brazil, with the suspension of the federal taxes and collection of ICMS (which can be done based on the general rate relating to ICMS-importation set by the State where the importing establishment is situated – in RJ, for example, it is equivalent to 18%; or the tax rate of 3%, without a right to credit, should the beneficiary have opted for the tax treatment referred to in the ICMS Agreement 03/2018).

The issue relating to the incidence of ICMS on these operations is the subject of great discussion, since the applicable legislation involves, as a condition for fruition of the benefit of the reduced rate of 3%, the need for adhesion tied to a controversial withdrawal (and waiver of the right) by the companies with regard to challenging in Court the incidence of ICMS on imports that do not involve the transfer of ownership of the imported goods, a matter that has already been decided, in the procedure of general repercussion (meaning that it is a biding decision for all Courts in the country), by the Federal Supreme Court (STF), in favor of the companies. In other words, the States tied the receipt of the benefits of Repetro at state level to the acceptance of a collection already recognized as unconstitutional by the STF.

With regard to the second group of modifications, among the different changes relating to the operationalization of the regime, we highlight its greater integration with the other tax ancillary obligations applicable to companies, and that, as a rule, are imposed upon different sectors of the economy.

Thus, the use of specific systems of control, regulated by the customs authorities of the Federal Revenue Service, opens the way for the integration of the operations under Repetro to the general rules of Sped, which generates the expectation of an increase in the level of control and, especially, an increase on the focus of the taxation at a state level under these operations.

Finally, with respect to the third group, about which we will analyze with more detail, we can point out: (i) the modification in the limit-percentages applicable to the so-called *contractual split* (the three party contracting model, with simultaneous execution of a service agreement and a charter, lease or hire agreement); (ii) the creation of specific restrictions for the bareboat charter parties, which do not apply to the time charter agreements, (iii) the obligation that the contracting party responsible for making the payments (usually, the Operator) be the importer and appear as beneficiary of the regime, relating to the principal goods imported based on bareboat charter, lease, hire, assignment or availability agreements; and (iv) the prohibition of the provision, in the service agreements, of a supply of goods to be consumed during the rendering of the services.

3.2 Impacts of the new rules on the contractual models and formation of prices in different segments of the industry

Starting with the four main groups of modifications highlighted in the introduction, we must now go on to briefly discuss the effects of each one of them on the contractual models practiced.

3.2.1. The modification in the limit-percentages applicable to the so-called contractual split

The modification of the percentages of the *contractual split* reduced the differences between the values of the charter party (lease or hire) and the values of the service agreements, for the majority of the vessels (such as drilling platforms and production platforms), with the only exception of offshore support vessels.

The reduction of the values liable for payment in the area of charter agreements generates, without making a change in the contract price formation, an increase in the tax burden on the charterer, because of the retention by the charterer (Operator) in Brazil, of Income Tax Withheld at Source (IRRF), at the rate of 15%, on the difference between the amount effectively paid based on the charter party and the limit amount calculated based on the percentages defined in the legislation.

This impact in terms of tax burden raised, at least, a further discussion of the contractual economic balance between the parties, especially for the contracts in course, bearing in mind that this is an imposed regulatory novelty which implies an impact on the cost of the charterer. Another side to this question, capable of generating a conflict between the parties involved, is the issue of proving that this increase in the tax burden applicable to the charter party effectively represents an increase in the costs of the charterer. Under the strict perspective of the contractual scope, this increase in cost is evident. However, under a broader view, this demonstration is very often complex, depending on the tax system applicable to the charterer in the jurisdiction in which it finds itself domiciled, so that the definition about which of the parties must bear the burden of the normative change tends to generate significant repercussion.

Another possibility to be considered, also with regard to this modification, is the revision of the contractual prices, so as to reduce the value of the charter contract, to make it compatible with the new limit-percentages of the *contractual split*. In this case, it would not imply the incidence of IRRF at the tax rate of 15% over the payment of the charter and the corresponding discussion about the burden of the levy, but, on the other hand the value of the service agreement would increase, which would be subject to PIS/Cofins (9.25%) and ISS (2% to 5%). PIS and Cofins are creditable and may not come to generate an impact, however, the ISS will represent an effective cost. Furthermore, depending on the additional increase of revenues from the service provider because of this new pricing, it could possibly transform the tax losses into taxable profits, which would represent an additional tax burden of 34% (IR = 25% and CSLL = 9%), which means a more substantial and perhaps prohibitive impact for the adoption of this format, without mentioning the possible need for financial restructuring required for the charterer due to the reduction in receivables.

3.2.2. The creation of specific restrictions for the bareboat charter parties

As for the differentiation made by the new rules regarding the requirements applicable to the bareboat charter parties and time chartering agreements, there is a trend towards preferential adoption of time chartering, to the extent that there are less requirements, however one must pay attention to the detailing of the scope of this contract, especially when their simultaneous execution with the service agreement is considered, so as to avoid questionings related to a possible simulation or characterization of importation of services (the tax burden for which is much greater than that of the charter party).

The charter agreement is the contractual instrument by means of which the Shipowner temporarily makes a vessel available to the Charterer through pecuniary payments.

However, in view of the different possible scopes it could have, it is considered to be a complex legal figure, surrounded by numerous discussions about its concept, applicable regulation, scope and legal nature, which can be segregated into 3 (three) main modes, namely: *bareboat charter*, *time charter* and *voyage charter*.

For purposes of this examination, we will focus on the similarities and differences existing between the first two modes of chartering (*bareboat charter* and *time charter*), bearing in mind that they are commonly used in the Brazilian O&G sector, so that we can proceed with addressing the impacts and risks generated by the new legislation.

Comparing the abovementioned ways of chartering, we conclude that the main difference between them resides in the party responsible for the control of the nautical management of the vessel which, in the case of the bareboat charter comes under the responsibility of the Charterer, while in the *time charter*, this obligation falls upon the Shipowner.

The statement above results of the fact that, while in the *time charter* the vessel is already available equipped and properly manned, in the *bareboat* charter the vessel is made available *as is* and the obligation to equip and man it is transferred in full to the Charterer, who will, in this case, be responsible for the seaworthiness of the vessel.

In this context, it is true that the alteration from the *bareboat* mode to the *time charter* mode requires, basically, the change of the party responsible for

the nautical management (nautical control) of the vessel under charter, it is essential that the Shipowner become responsible for preparing and equipping the vessel and for handing it over in seaworthy conditions.

It is important to note that this shift of the responsibility of the nautical management involves, essentially, the assumption of the costs relating to it, by the contractual party encumbered with this. However, there is no requirement that the personnel assigned to such activities are necessarily listed on the payroll of the Shipowner. It is possible, in this sense, for example, that the charterer subcontracts this workforce, or even that it promotes the reimbursement of the costs relating to the relevant professionals, from the related services provider domiciled in Brazil.

In view of the above, it is possible to conclude that the adaptation of the nature of the contracts, to satisfy the new rules, involves not only a review of the contractual objective, but also the establishment of a careful and transparent segregation of the costs and responsibilities arising purely from the nautical management of the vessel, from those relating to the commercial management, i.e., to the operation of the vessel.

In this sense, it is necessary, for example, to exclude from the charter party typical service agreement clauses related to the operation of the vessel, which occurs very often in the contractual models practiced in the O&G industry in Brazil.

That concern results of the fact that the presence of typical elements of the provision of services, if existing in a charter agreement, would increase the risk that the tax authorities understand that the chartering has not been characterized, and consequently impose on the charter payments the tax applicable to the import of services (IRRF, Cide, PIS, Cofins and ISS), instead of the general exemption that is applicable to the payments for the charter of vessels (including platforms)..

Thus, our understanding is that the *time* charter agreements must be limited to considering, as the scope of services, the presence of a minimum crew, required for the nautical management of the Unit, which will vary according to the type and the size of the vessel to be made available. All the other obligations to do should be provided for exclusively in a services agreement, under the penalty of weakening the strict characterization of the contract as a time charter agreement, and not a services agreement.

3.2.3. The obligation to import by the operator

With regard to the situation in which the Operator would become the entity responsible for the import, the trend is that this possibility, in practice, is also avoided, bearing in mind the lack of interest of the Operators in assuming the responsibility for the management of a series of assets (and accepting the responsibility for the risks inherent to the application of their regime) which currently are the responsibility of the contractors. To assume such responsibilities, besides reducing the cost of the remuneration of the contractors (because of the reduction of the associated risk), the Operators would have to invest in personnel, so as to expand its tax and foreign trade/ logistics departments, which makes this alternative very unfavorable to them.

Therefore, a first viable alternative to avoid the applicability of this restriction, in the case of contracts involving the operation of vessels, among them production and drilling platforms, is entering a time charter agreement instead of a bareboat charter, bearing in mind that the obligation of importation by the Operator does not apply to time charter agreements.

In this context, the comments set out in the previous topic should be observed, either for the verification of the compliance of any existing contract with the conditions for classification as a time charter, or for the implementation of the necessary adaptations, by means of an amendment, if it is found that the nature of the current contracts is different, that is, that of the bareboat charter (since time charters, normally, are not used in the sector).

Another possibility, which affects not only the contracts involving vessels, but also those related to other equipment, would be the use of the procedure of importation by order, so that the service providers may promote the adoption of all the procedures relating to importation, however, on behalf of the Operator.

It should be noted, however, that this mode of importing results in the joint liability of both companies, besides not removing the responsibility of the Operator for the fulfillment of the requirements and conditions that remain applicable while the suspension of the taxes due on the importing lasts. Anyway, the performance of these activities can obviously be subcontracted, including with the service provider itself, with a contractual agreement about the remuneration for such activities and the division of responsibility, even though this agreement between the parties merely provides grounds for any right of appeal, since it cannot be relied on against the tax authorities.

Finally, there also exists the possibility that the format of use of contracts of simultaneous execution with the Operator may be modified, either by means of the making of hire, lease, charter or loan for use agreements, between the service provider in Brazil and the holder of assets abroad (usually related companies) – together with a local services agreement and the Operator – or through the making of a single services agreement, between the holder of assets abroad, and the Operator in Brazil.

In case of a contract between related companies, combined with a local services agreement, the taxation, in theory, would be less, since the contract between related parties would involve only making the asset available (obligation to give, and not to do), so that on the remuneration established therein only IRRF would be due, while on the local services agreement, PIS, Cofins and ISS would be due.

On the other hand, this format requires that the value of the payments to be made within the scope of the hire, lease, charter or loan for use agreement, be limited to the value of the imported goods themselves, at the time of the importation.

In the case of a single contract for the importation of services, between the holder of the assets abroad, and the Operator in Brazil, the applicable tax burden will be significantly greater, since on the remuneration relating to such a contract IRRF, Cide, PIS, Cofins and ISS will be due.

3.2.4. The prohibition to the supply of goods to be consumed during the provision of services

Finally, with regard to the prohibition relating to the supply of goods within the scope of the service agreements, there is a relevant impact on the service agreements that, very often, have a mixed nature, containing the supply of goods, besides the provision of services, and also various cases of remuneration for the standby time of the goods assigned by the service provider for use in the contact.

The new rules imposes a pricing format exclusively based on the services, besides a focus on the contractual provisions described above, so that the wording of the contract does not generate problems of interpretation and questionings on the part of the tax and customs authorities, and that any

portions of the scope that might result in non-compliance with the rules of Repetro, be segregated in a separate contract.

The resulting concern of the innovation described above results from the fact that, in the contract models commonly practiced in the O&G sector in Brazil, the service agreements contain PPUs listing a series of items, in general priced by unit or weight.

It is important to explain, however, that the relevant aspect, for purposes of definition of the applicability or not of the restriction brought by the new legislation, refers to the existence or not in the contracts of supplies of goods by the contractor to the contracting party. In other words, the prohibition refers to the sale, by the contractor to the contracting party (with payment either with a profit or at cost), for the supply of goods or merchandise employed in the execution of the services.

This prohibition shall not to be confused, however, with the mere contractual listing of goods that must be used by the service provider within the scope of the execution of the contract, and that are not sold or supplied to the contracting party.

In our opinion, the restriction will not be violated if these goods are listed only for the pricing format of the services provided in the contract, especially for identification of the quantity of national and imported goods to be imported in the execution of the services, so that the contracting party might have greater visibility regarding the composition of the price of the service provider and might, in this way, ensure both a more precise verification of different proposals at the time of the procedures of contracting, as well as ensuring the preservation of the economic-contractual balance, whenever there are any variations in the costs considered by the contractor.

The important requirement, in this context, so that the is no non-fulfillment of the prohibition provided for in the new regulation of Repetro, is that the scope of the service agreements not include the sale of goods, nor reimbursement by the service provider, even though the cost of goods might be considered in the PPU for the composition of the price to be charged for the provision of services, and this price will be fully charged by means of a service invoice and submitted to taxation for services (in the case of local services, PIS, Cofins and ISS).

4. Law nº 13,365/2016 and the end of the sole operator system in the pre-salt areas and strategic areas

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In 2010, Law nº 12,351 was enacted and established the regulatory framework for the Production Sharing regime for exploration and production of oil, natural gas and other hydrocarbon fluids in the areas of the pre-salt and those deemed as strategic by the National Council of Energy Policy (CNPE). The delay in approving the law, approximately five years following the discoveries of the pre-salt in Brazil, had already drawn criticism. The content of such regulatory framework established by the Law, however, was questioned even more.

The result of such an overdue legislative effort was an overly restrictive model, which did not permit competitiveness in view of the intense presence of the state it required and was further aggravated by the financial and logistics challenges inherent to the activity in the region, along with the economic and political circumstances of the country shortly after the approval of the Production Sharing Law. The effect was a low market interest in the assets offered under auction and, as a consequence, an underutilization of the productive potential of the reserves of such hydrocarbons.

Initially, it must be emphasized that the framework conceived by the Federal Government in the original wording of the Production Sharing Law was motivated at the time by its political agenda to reinstate Petrobras as the central figure in the entire productive chain upon assigning to it various prerogatives in the area of exploration and production of the pre-salt and strategic areas. Additionally, the Government intended to constitute a Social Fund in order to fight poverty and regional inequality, set up a public savings account and to mitigate income and prices fluctuations in the Brazilian economy resulting from variations in the revenue from production and exploration activities of

petroleum and other non-renewable resources[1], by means of application of the resources arising from the signature bonus, royalties, and revenue from the commercialization of the hydrocarbons, among other sources established in article 49 of the Production Sharing Law.

Although the intention of the Federal Government to set up the referred Social Fund may be praiseworthy, the Law fell short by not giving attention to sensitive points with regards to the economic feasibility of the proposed Production Sharing regime, which hindered any greater dynamism and was vulnerable to any eventual downturn in the financial situation of the central figure of the activities, namely, Petrobras.

With regard to the lack of dynamism of the model, such was as a result of the non-isonomic treatment conferred by the Production Sharing Law in favor Petrobras and in detriment to the other oil companies, as well as of the impacts resulting therefrom. The original wording of the Law provided for two forms of contracting by the Union, through the Ministry of Mines and Energy:

- The Union could enter into a Production Sharing contract directly with Petrobras, in which case the bidding process would be dispensed, in connection with areas as so deemed by the National Energy Policy Council (CNPE), in view of their relevant national interest; or

- The Union could contract, through a bidding process via auction, a consortium formed, obligatorily, by (i) the winning bidder, (ii) Pré-Sal Petróleo S.A. (PPSA) – a state-owned company created by the Production Sharing Law to undertake the management of the consortium contract – and (iii) Petrobras, which should be the sole operator of the consortium and whose minimum participation in the consortium would be proposed by the Ministry of Mines and Energy to the CNPE but could not be inferior to 30%.

In this regard, Petrobras was appointed to conduct the direct or indirect execution of all the activities of exploration, evaluation, development,

1 Law nº 12,351/2010 (Production Sharing Law): "Article 48. The Social Fund aims at: I- constituting long-term public savings based on revenues accrued by the Union; II- offering a way to raise resources for social and regional development, as provided for in article 47; and III- reducing income and price fluctuations in the domestic economy arising out of income variations generated by oil exploration and production activities and other non-renewable resources".

production and decommissioning of the exploration and production facilities. Evidently, the effectiveness of this measure was intrinsically linked to its investment capacity.

This connection with the investment capacity of the state-owned company was precisely the reason behind one of the most severe criticisms of having a sole operator in these areas. Amidst the repercussion in the press and public opinion of numerous episodes of poor management of Petrobras' resources and principally the outcome of Operation *Car Wash* (Operação Lava Jato), which was a combined task force involving the Federal Police; the Federal Prosecutions Office and the Federal Justice, among other local and Federal agencies that reveled and dismantled a huge political corruption scheme, in which several members of Petrobras´ higher management were convicted for corrupt practices, as well as the resulting negative financial and reputational impacts, aggravated by compensatory lawsuits abroad as a consequence thereof, the state-owned company was obliged to implement a more restrictive investment policy.

The aforementioned effect on the investment policy of Petrobras came up against the imposition – due to the Production Sharing Law – that it would be the sole operator of all the blocks. Not only had the state-owned corporation lost its autonomy to prioritize the allocations of its resources but it was also obliged by law to invest capital, technology and personnel in an activity of exploration and production in pre-salt and strategic areas, besides having a 30% minimum stake in bid-winning consortia.

This incompatibility was further aggravated by the costs and logistics challenges inherent to the production of oil, natural gas and hydrocarbons in the pre-salt areas. The distances between the exploratory blocks and the coasts are greater, as is the depth, which demand even higher expenditure with equipment, personnel and technology.

It should be noted that the criticisms relating to the investment capacity of Petrobras were not the only ones directed against the single operator system. Due to the lack of power that the consortium members would have to influence the operations of the consortium since PPSA would be responsible for the management of the contracts, oil and gas companies found unattractive to invest the high resources required for the operations. Furthermore, because of the sole operator system, the participation of these companies in the activities of exploration and production of these hydrocarbons would be purely financial and such companies would not be able to decide on any matters surrounding the

consortium guidelines or even to contribute with their respective technologies; being subject, however, to the decisions of the Operational Committee (Opcom) which could imply in additional costs.

In such context, the First Round of Bidding under the Production Sharing regime – the only one occurred while the original wording of the Production Sharing Law was in force – offered an area in the Libra field , however, it was awarded to Petrobras and other companies without any effective competition between them. Given that situation, it was concluded that the model was not attractive enough as originally conceived and resulted in low competitiveness in the sector to develop the assets.

At the same time, several entities related to the oil and natural gas sector were favorable to the reform of the Production Sharing Law and expressed such opinions to civil society, especially *The Brazilian Association of Petroleum Service Companies* (Associação Brasileira das Empresas de Serviços de Petróleo – ABESPetro), the *Brazilian Institute of Petroleum, Natural Gas and Biofuels* (Instituto Brasileiro de Petróleo, Gás e Biocombustíveis – IBP) and the *Federation of Industries of the State of Rio de Janeiro* (Federação das Indústrias do Estado do Rio de Janeiro – Firjan).

Additionally, the debate for the reform gained support by the favorable statements of the governments of the states of Rio de Janeiro and Espírito Santo, which are the main oil and natural gas producing states in the country and also those most benefitted by the levy of royalties from the exploration and production process.

Jointly with the appeals by Petrobras, state governments and entities linked to the oil and gas sector, the discussions surrounding the amendment to Law 12.351/2010 took place in a context of political crisis. Following the conclusion of the process of impeachment of President Dilma Rousseff in 2016, the Federal Government came to be composed by a group with administrative proposals tending towards free initiative and free competition, which made the political scenario more favorable for discussing more flexible rules in relation to the sole operator.

In fact, although the government of Dilma Rousseff had indicated that it would consider terminating the sole operator system in the pre-salt, only during the government of Michel Temer that such reform became reality. After the due discussions in the Brazilian Congress, Bill nº 4,567/2016, presented by congressman José Serra, was approved and published as Law nº 13,365/2016.

By means of this reformed law, CNPE was now tasked with offering to Petrobras the preference to be operator of the blocks to be contracted under

the Production Sharing regime[2]. The state-owned company will then have 30 (thirty) days to reply to CNPE, presenting the justifications for its decision. In other words, Petrobras is no longer obligated to be operator of the blocks. Thus, should the company not consider the prospect attractive, it can waive its preference and then the block will be offered for exploration by the market, in compliance with the law and the respective invitation to bid.

It is also worth noticing that, should Petrobras exercise its preference to be the operator of the block and should the contracting be defined by means of a bidding process, a minimum percentage participation of the state-owned corporation in the consortium continues to be mandatory. CNPE shall indicate the percentage though it cannot be less than the same legal limit of 30% (thirty percent) introduced by the original wording of the Production Sharing Law.

In spite of that, the legislative amendment was well received by the market, opening up the way for new bidding rounds , so that the 2nd, 3rd and 4th Rounds under the Production Sharing regime were successful, and in the 2nd and 3rd Rounds, as a result of the great competition among the oil companies, six of the eight offered areas were sold, with relevant figures in signature bonus and significant quotas of surplus oil for the Union. With respect to the 4th Round, it is interesting that Petrobras, after a period of financial restructuring and of review of its investments performed by the new administration, exercised its right of preference for three of the four areas under offer.

Evidently, despite being praised and having brought significant impacts on the competitiveness of the sector in the country, the fact is that the legislation for the pre-salt is still subject to question and could be improved in the future[3],

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2 Likewise: "Article 4. The National Energy Policy Council (CNPE), considering the national interest, will offer to Petrobras the preference to be operator of the blocks to be contracted under the production sharing regime".

3 Prior to the approval of Law nº 13,365/2016, Bill nº 417/2014, elaborated by Senator Aloysio Nunes Ferreira, was presented to the Senate, and it made provision precisely for the replacement of the sharing system by the concession system in these areas. However, this bill was withdrawn by the Senator who wrote it and was filed. In 2017, the current President of the Lower House of Congress, Rodrigo Maia, even suggested that the end of the Production Sharing regime and adoption of the concession system for the as-yet unoffered areas of the pre-salt also be included in the agenda for discussion in the House. However, the President of the Lower House later suggested that, in substitution, the end of the so-called polygon of the pre-salt, defined as the area described in Annex I of the Production Sharing Law be included in the agenda. Up to the current date, no Bill has been presented in this respect.

and for a certainty, the achievement of such new reforms will depend on the economic, social and political framework of Brazil, since the new composition of the Congress, as well as of the Executive Branch, will be fundamental for the continuation of these discussions.

PART II

PURCHASE OF O&G ASSETS

5. Acquisition of O&G assets and Petrobras' mature field divestment project

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5.1 M&A in the O&G area

M&A operations are quite common in the O&G sector, involving relevant and complex transactions. In the second quarter of 2017, M&A operations in the O&G sector in Brazil rose 200% compared to the second quarter of 2016, according to a study by KPMG. A recent survey (June 2018) by Ernst & Young indicates that 3 out of 5 oil and gas companies intend to make acquisitions in the area in the next 12 months and 60% of the executives interviewed stated that they intend to carry out acquisitions predominantly in the United States, Brazil and Canada.

Such operations are structured in the form of assignment of rights of a concession contract.

Article 29 of the Petroleum Law[1] provides the legal basis for the transfer of the concession contracts, provided that their objective is preserved and the contractual conditions are agreed with ANP and that the new concessionaire meets the criteria adopted by the agency for approval of the assignment of rights, as provided in article 25 of the same law.

The contract executed in this type of operation is a Farmout Agreement, also known as a Sale and Purchase Agreement, which is commonly executed between oil companies that buy shares or withdraw from consortia, depending on their portfolio of blocks and the results of their exploration and production areas in different countries.

1 Law nº 9,478 of August 6, 1997.

In Common Law, the provisions of the Farmout Agreement must govern the private relations between Farmor (assignor) and Farmee (assignee) with respect to the rules for assignment and the corresponding acquisition or sale of the exploratory rights of a granted or contracted area.

The Farmout Agreement finds its equivalent in Brazilian Law in the Assignment Agreement. The former is nothing more than a detailed and expanded version of the latter, with clauses that minutely discipline the parties' relationship in the private sphere, before and after the signing of the respective assignment, it being understood that many of the provisions contained therein need not be submitted to the regulatory agent.[2]

We emphasize the importance of performing a due diligence in this type of operation, since the Farmout Agreement must regulate the responsibility of the seller and buyer in relation to the liabilities of the operation object of the M&A.

In fact, the standard model of the Assignment Agreement approved by ANP requires that the assignor and assignee undertake to comply fully and strictly with the obligations set forth in the terms and conditions of the Petroleum Law and the concession contract, being jointly liable for the obligations therein before ANP and the Federal Union, including those incurred before the date of the assignment and until the execution of the final agreement.

Therefore, in the Farmout, the allocation of the obligations between the various co-obligors is recommended, and a clause should be inserted where the assignee undertakes to hold the assignor harmless from any and all claims arising from this joint and several liability after execution of the Assignment Agreement.

Since the assignment of a contractual position is a contract, which falls within the scope of the Brazilian Civil Code, the solidarity agreed between assignor and assignee before the Union and ANP constitutes a very burdensome obligation that remains on the assignor, who withdraws from that concession.

This solidarity may, in theory, oblige the assignor of a block in the exploration phase to indemnify the Union, years afterwards, for example, for an oil spill that caused environmental damage occurring during the production stage due to the exclusive fault of the assignee and its representatives.

Another clause widely used in the petroleum industry is the one which reserves to the assignor the right to participate in the results of the production

2 National Agency of Petroleum, Natural Gas and Biofuels.

of that assigned block, provided that the price of the assignment has been fixed based on a maximum perspective of production in the assigned block.

In effect, in these transactions the transferring party makes the data and information available to the assignee, so that it can evaluate the economic value of the block and determine a price. Then, if the actual result of that assigned block exceeds the agreed value, it is common for the assigning oil companies to guarantee for themselves, in the Farmout Agreement, a future percentage on the production of that block.

5.2 Petrobras' divestment procedure and applicable legislation

We now turn to the divestment procedure of Petrobras, which regulates the disposal (M&A) of the company's assets and concessions (acreage).

Although Petrobras is a mixed-capital corporation, part of the Brazilian indirect Government, under the first paragraph, item II, of article 173 of the Brazilian Federal Constitution (Constitution), it is subject to the private law regime with respect to its business relations.

However, as a part of the indirect Administration, Petrobras is obliged to adopt the bidding procedure in its contracts, as well as to observe the general principles applicable to members of the Federal Administration, such as the principles of legality, impersonality, morality, government transparency and efficiency (see head provision of article 37 of the Constitution).

As already mentioned, with the advent of Constitutional Amendment nº 9/1995 and the subsequent edition of the Petroleum Law, according to which Petrobras was inserted in an environment of free competition with other oil companies, it became necessary to adopt special contracting rules to allow Petrobras to contract goods and services more quickly and efficiently.

Therefore, the Petroleum Law established that the contracts entered into by Petrobras should be preceded by a simplified tender procedure, replacing the previously applicable Public Procurement Law (Law nº 8,666 of June 21, 1993).

Thus, Petrobras' Simplified Bidding Procedure was published by Decree nº 2,745/1998 (Decree) and then supplemented by the rules contained in Petrobras' Manual of Contract Procedures, now called the Petrobras Contracting Manual (MPC), the provisions of which have the same degree of hierarchy as the Decree, as a result of item 10.1 of the latter (Decree).

It should be noted, however, that on July 1, 2016, Federal Law nº 13,303 (State-Owned Corporations Law) was enacted, which, among other things, created the legal statute of mixed capital companies, expressly revoking article 67 of the Petroleum Law and, consequently, the Decree.

After the State-Owned Corporations Law, the transfer or onerous assignment of Petrobras assets was regulated by a new program for Divestment of Assets and Companies of the Petrobras System (*Divestment Program*). This document details all the stages of the process, defines the parties involved, the responsibilities of each area and the governance of the process, among other aspects.

The Divestment Program of Petrobras has already suffered some criticism and has had to undergo amendments, by court order. As an example, on March 6, 2016, an administrative proceeding was instituted to investigate the arguments brought by the Oil, Natural Gas and Mining Infrastructure Supervisory Office (Seinfra-Petróleo) against the then existing version of the Divestment Program. Seinfra-Petroleum initially questioned (i) the compliance of the Divestment Program with the legal system in force, (ii) the need for legislative authorization for the disposal of a mixed capital company subsidiary, and (iii) the verification of mandatory application of the national privatization program.

On March 29, 2017, the Federal Accounting Court (TCU), through Judgment nº 442/2017, granted the Representation of Seinfra-Petróleo, which resulted in modifications that had to be made by Petrobras to the Divestment Program(which currently has TCU approval).

It should be noted that on March 14, 2018 Petrobras' Board of Directors approved the company's adhesion to the regime established in Decree 9,188, dated November 1, 2017. The ruling, which regulates the Special Regime for the Divestment of Assets by Federal Mixed-Capital Companies for purposes of compliance with the State-Owned Corporations Law, establishes rules of governance, transparency and good market practices, with the aim of bringing greater clarity and legal certainty to the procedures. The Decree establishes the rules for the formation and termination of partnerships, corporate or contractual, the acquisition and disposal of participation in companies and other forms of association and the operations carried out by state-owned companies in the capital market.

The divestments of Petrobras are further regulated by Decree 9,355/2018, which determines the steps and guidelines to be followed by Petrobras, its

subsidiaries and controlled companies, in the assignment of exploration rights, development and production of oil, natural gas and other hydrocarbons. In addition to discussing the characteristics of the seven phases of the operation (between the preparation and signature of the legal instruments), the Decree allowed Petrobras, in the contracting of goods and services when acting as operator of private consortia, to be exempted from the bidding procedure (subjecting Petrobras to the specific regime for private companies).

The divestment process is very complex, starting internally with the preparation of the project by Petrobras, which will define the business model and prepare the asset for sale (which involves the description of existing and future contracts, regulatory issues, among other things). The official launch of the bidding process is marked by the disclosure of the teaser (sales alert) to the market, which will contain the initial information on the investment opportunity.

Potential buyers who are qualified in the first stage (through the submission of non-binding proposals) will start the due diligence process by accessing a virtual data room containing more information about the project, as well as instructions about the divestment process, including the guidelines for the preparation and submission of tender proposals. It will also be possible for the participants in the process to submit questions that will be answered by Petrobras in accordance with the schedule and rules specific to the process.

The due diligence phase, as in all merger and acquisition operations, is essential for the identification of already materialized contingencies, conducts that can lead to future liabilities, possible liens or encumbrances of the assets, compliance with applicable legislation and adoption of good practices by the target-company, a better understanding of the state of the asset, verification of potential difficulties in the operation, etc. This analysis will be used to calculate the price at the presentation of the binding proposal, as well as to establish the terms and conditions in the negotiation of the purchase and sale agreement.

Petrobras will also be able to schedule technical visits where more detailed information will be provided and it will be possible for the bidders to visit the fields and platforms.

The presentation of the binding proposal should be accompanied by a revised version of the draft contracts to be signed for the execution of the intended legal transaction.

Finally, Petrobras will select the most favorable offer, according to established criteria that should take into account the greatest economic benefit for the company.

5.3 Critical issues in the Farmout/SPA negotiation and completion of the operation

In addition to the issues peculiar to a process of acquisition of assets of Petrobras, as a mixed-economy company, challenges arise for the investor in the process of divestment of mature fields, regarding acts extrinsic to the business itself, which are beyond the control and negotiation of the parties. We refer, particularly, to acts that depend on the discretion of the regulatory agency of the sector, the ANP.

The first question that is identified refers specifically to the blocks of Round Zero, that is, those granted to Petrobras under Law 9,478/1997 – Petroleum Law – which, when removing from Petrobras the exclusive exercise of the State's monopoly for hydrocarbon exploration and production activities, granted Petrobras the rights to exercise such activities for a period of 25 years.

Therefore, the term of Round Zero concessions expires in 2023 and investors, who are currently interested in acquiring these rights have as a basic premise for the viability and attractiveness of a business in which large investments are required and the costs and obligations so relevant, the need to have the term of the concession extended. This is because the purpose of the business is precisely to extend the productive life of the fields in which Petrobras has no more interest in continuing to invest in, given the priorities imposed by the discovery of very promising areas such as the Pre-salt.

Considering that only the concessionaire has the legitimacy to request extension of its concession contracts to ANP and that it makes no sense that Petrobras, having decided to dispose of such rights to third parties, should submit to ANP an extension application that must be based on a development and investment plan that will no longer be Petrobras', there is a situation of impasse or rather, uncertainty, since the potential buyer has to make an offer for an acreage whose concession currently ends in 2023 in the expectation that this concession agreement will have its term extended by ANP.

This uncertainty was somewhat mitigated – though not totally overcome – by Resolution nº 17 of the Energy Policy Council (CNPE), of June 08, 2017,

which dictated, in its article 3, VIII, as one of the guidelines to be followed by ANP to "encourage the extension of useful life of the fields, while promoting a culture of preservation of safety conditions and respect for the environment". In this sense, in principle, ANP should be willing to extend the term of the concession of mature fields, it being understood that the new concessionaire must present a development plan that gives the Agency elements to support a favorable decision. At this moment, the degree of discretion of the ANP cannot be ignored, which undoubtedly brings uncertainty to the investor in relation to the purchase of the assets in question, since, again, the extension of the term of the concession is a basic premise of this business.

Another recurrent issue in Farmin/Farmout transactions in Brazil, and the process of divesting of mature fields will not be an exception to the rule, is that the assignment of the concessionaire's rights to engage in oil and natural gas exploration and production activities only takes place by means of the approval of ANP of the respective assignment. Thus, the sale and purchase agreements include a resolutive condition concerning ANP's approval of the assignment.

For oil companies already established and registered with ANP (whether as operators A, B or C or non-operators) or non-operators, this condition is naturally of less concern, since they are already recognized as agents qualified for the activities in question by the Agency.

However, for newly established companies, the approval of the assignment term will also go through the previous stage of registration before ANP, as operators or non-operators capable of carrying out E&P activities. The above-mentioned Resolution nº 17/2017 of the CNPE, in its article 3, subsection VII should be noted in this regard, as it establishes the need to incentivize the development of medium and small oil and gas reservoirs.

Depending on the value of the purchase of rights, there may still be a need for approval by the Administrative Council for Economic Defense (Cade), which is also usually a resolutive condition for the transactions regarding concession rights assignments.

In conclusion, although there is no doubt that CNPE Resolution nº 17/2017 stablished guidelines for the development and opening up of the oil and gas sector, clearly aimed at expanding the market for mature fields (lesser attractiveness) to small companies and medium-sized companies, processes such as the ones we have seen regarding the divestment of mature fields of Petrobras still pose a challenge for investors interested in preparing their offers and evaluating their risks.

6. Impacts of operation Car Wash: How to prevent the accountability of managers and reduce risks in M&A operations

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6.1 The context

Car Wash and other related operations that appeared in recent years to investigate acts of corruption in various sectors of the government had a major impact in Brazil. For the first time, the country saw powerful entrepreneurs being sentenced and arrested for this type of crime. Unprecedented penalties were applied to major business conglomerates, which had their names, brands and reputation heavily shaken due to involvement with wrongdoings.

The severity of the adverse judgments – including that of a former president of the Republic – demonstrates the rigidity with which the Public Prosecution Office and the Judicial Branch have been enforcing the law, it being increasingly clear that a certain type of behavior, on the part of both public and private sector agents, is no longer acceptable in the eyes of these authorities.

Recent decisions also show that, contrary to what the traditional procedural-criminal theory teaches, a set of facts and its mere contextualization may, indeed, serve as proof of wrongdoings – even if the facts taken individually were not enough for an adverse judgment. It is no longer possible to rely on formalities to avoid it.

In parallel, and as a demonstration of the same phenomenon of intolerance towards the practice of such acts, the Anti-corruption Act (Law nº 12,846/2013), published in 2013, also provided liability – in the administrative scope – to the legal entity involved with corruption, whereas,, this liability, theoretically, will be transferred to whomever eventually acquires that entity.

Finally, the new parameters for holding managers of companies accountable and the penalties established by the Anti-corruption Act produced significant

impacts on the business sector, making the taking of management positions in large companies and the acquisition of assets from major conglomerates (especially those from groups that contract with the Government, that are beneficiaries of tax exemptions, etc.), in a way, undesirable. Theory and practice demonstrate, however, that it is, indeed, possible, if not remove, at least to mitigate these risks.

6.2 Care needed to protect the managers (and, ultimately, also the companies)

The high number of convictions rendered against top executives has been celebrated, on one side – for breaking the stigma that business crimes would be a synonym for impunity in Brazil –, and criticized, on the other – in general due to alleged violations of individual rights on the part of the authorities.

Certainly, in principle, the acceptance of criminal complaints by the Judiciary – to start the criminal procedure – should depend on the existence of a *just cause*[1], *that is, minimum evidence to impute the perpetration of a crime to a given person. Theoretically, generic complaints, which does not individualize the effective participation of each one* of the accused for the commission of the crime, is not admitted.

However, considering that these are accusations of crimes committed within the business context (including corruption proposed by a private citizen to a public officer, money laundering, environmental crimes, etc.), there is a consolidated understanding by the courts in the sense that a detailed description of each of the acts would be unnecessary.[2] *This circumstance, not rarely, allows for the institution of criminal procedures only by reason of the office or corporate position held by a given person, without the indication of elements that would minimally prove their effective participation in the crime*[3].

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1 Code of Criminal Procedure, article 395, III.

2 For example: "(...) In corporate crimes, the detailed and meticulous description of the conduct of each perpetrator is dispensable, only the description of the typical fact, the common circumstances, the reasons for the crime and sufficient evidence of the perpetration being enough, even though succinctly, so as to ensure the opportunity to be heard and adversary proceeding (...)" (Federal Supreme Court, Electronic Court Register of December 16, 2016, HC 136.822 AgR, Judge Rapporteur Luiz Fux).

3 For example: "(...) According to the Federal Prosecutor, the illegal actions were practiced by the defendants because they were managers of said legal entity, holding, in the referred period, the

This scenario inspires a series of precautions, not only to minimize the risks of generalized criminal accusations against managers – and also against members –, but also to increase the chances, should a criminal lawsuit be filed against executives not related to the facts, of prematurely removing them from the procedure.

In this sense, amidst a pendular movement clearly favorable to the prosecution, there are still legal precedents that determine the early dismissal (or *summary dismissal*) of criminal lawsuits upon the understanding that, in the respective situations, there would be no indication of actual participation of certain managers in the perpetration of the corporate crimes attributed to them[4]. In the absence of clearer and more objective parameters in the legislation and majority court precedents – to establish which point the criminal accountability of the managers may go –, the analysis of these specific cases and the legal decisions therein rendered is an important starting point to think about preventive measures against this type of accusation.

And the conclusion is that, despite the oscillation inherent to the Judiciary, there are mechanisms that allow companies, to some extent, to mitigate the risks of generic criminal complaints and increase the chances that such procedures, if filed, might be dismissed.

In this sense, so as to obtain the early dismissal of a criminal lawsuit, although only in relation to a given person or persons, it is necessary that the mistake in the accusation to be clear. After all, as registered, in case of doubt

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domain of fact, that is, the power to determine, decide and cause their employees and contracted parties to perform the act, being, therefore, those responsible for the aforementioned criminal offense. (...) the description of facts exposed by the Federal Prosecutor in the initial complaint satisfactorily meets the legal requirements to ensure to the defendant the opportunity to be heard and adversary proceeding." (Superior Court of Justice, Electronic Court Register of February 01, 2017, RHC 77.050, Judge Rapporteur Jorge Mussi).

4 For example: "(...) it is not enough to claim that the accused was in a hierarchically higher position to assume that he had controlled the whole perpetration of the crime, with full powers to decide on the commission of the crime of illegal transfer of funds abroad, its interruption and circumstances, especially considering the structure of the companies of which he was the chief executive officer, which had a financial board, within the scope of which the operations hereby incriminated were performed. It is therefore required in this kind of action that the information would describe acts materially attributable to the accused, consisting of the minimum evidential platform revealing his intentional contribution towards the crime". (Federal Supreme Court, j. of December 06, 2016, HC 127.397, Judge Rapporteur Dias Toffolli, pending publication). See also: Federal Supreme Court, Electronic Court Register of September 27, 2016, HC 127.415, Judge Rapporteur Gilmar Mendes.

as to the possible participation of the accused(s) in the supposed crime, the tendency is the acceptance of the complaint the and the pursuance of the criminal procedure.

For this reason, it is important for the company to have clear rules defining the (effective) attributions of its various bodies and positions. Effectively, when making the visualization of the various groups of attributions existing in the company easier, the measure will possibly reduce the risks of generic criminal complaints and increase the chances that, if the procedure is initiated, its summary dismissal may be obtained in relation to the managers whose activities are not related to the facts subject of the accusation.

Besides that, it is recommended that companies have effective management systems for the specific risks of their activities. Thus, for example, financial institutions must be careful about preventing money laundering; companies contracting with the Government should ensure the consistency of such hiring; and companies exploiting natural resources should prevent and contain environmental damage.

Certainly, although it is traditionally said that the manager may not be held liable unless they had received an alert (*red flag*) demanding that they act to prevent the implement of a given risk[5], *the current practice demonstrates that the mere existence of a red flag may not be enough to exempt them from this liability. For sure, it will also be necessary that they have ensured the creation and maintenance of mechanisms allowing for the identification of red flags and their effective handling. Corporate law experts already indicate this evolution, according to which the duty of due care* covers the obligation to create and maintain effective risk management and control structures[6]. This concern is also reflected in the evolution of the Code of Best Practices for Corporate Governance, of the Brazilian Institute of Corporate Governance (IBGC), the current version of which had a significant improvement concerning this aspect, when compared to the previous ones[7].

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5 For all: EIZIRIK, Nelson. *A Lei das S/A Comentada*. v. III, São Paulo: Quartier Latin, 2015, p. 124.

6 Check, for example, YAZBEK, Otávio. Representações do dever de diligências na doutrina jurídica brasileira. In: KUYVEN, Luiz Fernando Martins (coord.). Temas essenciais de direito empresarial: Estudos em homenagem a Modesto Carvalhosa. São Paulo: Saraiva, 2012, p. 957-8.

7 Check the current version: "4.5 Management of risks, internal controls and compliance. (...) Practices: (...) g) The board, aided by the control bodies linked to the board of directors (audit committee, see 4.1) and internal auditors (see 4.4), must establish and operate an effective internal controls system to monitor the operational and financial processes, including those related to the management

And, beyond the compliance instruments – largely discussed in the current scenario –, the traditional corporate governance mechanisms (boards, board of directors, audit committee, committees, auditors, etc.) also have special relevance within this context. After all, a company with management and control bodies with clearly defined attributions, fluid interaction among them and made up by qualified professionals with complementary expertise will certainly reduce the risk of generic criminal accusations, in addition to providing efficiencies that will certainly be reflected in better risk management.

6.3 New care in M&A operations

The paradigm shift resulting from Operation Car Wash and related movements also affected the conduction of M&A operations. .

Until recently, the main concerns of the investors interested in acquiring assets in Brazil, in general, were directed towards labor and tax risks and, depending on the sector, regulatory and environmental ones. More recently, however, the focus of due diligence on the operations has migrated to the risks involving compliance and meeting the Anti-corruption Law.

As mentioned, this Law innovated when provided objective liability (regardless of fault or intention) for illegal acts practiced on its behalf or its benefit (art. 2º). Its art. 4º establishes, not very clearly, that this liability does not end in case of corporate alteration. Thus, in view of the broad and generic nature of the law, there is no way of repelling the risk that the liability for acts of corruption may remain even in case the business is sold, whether by means of control change or corporate restructuring.

Besides, the Law establishes that companies belonging to the same economic group are jointly liable for the practice of illegal acts (art. 4º, § 2) – so that, in an acquisition, the buyer may take into its group liabilities involving illegal acts practiced by the target company or any other of its former conglomerate, even if not related with the business being acquired.

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of risks and compliance. It must also, at least once a year, assess the effectiveness of the internal controls system, as well as render account to the board of directors for such assessment. h) The internal controls system must not focus exclusively on monitoring past facts, but also consider a prospective view in the anticipation of risks. The board must ensure that the internal controls system encourages the bodies in the organization to adopt preventive, prospective and proactive measures in the minimization and anticipation of risks".

In this legislative scenario, from the buyer's point of view, the anti-corruption due diligence – including with the use of forensic investigation tools, as the case may be – becomes an essential element in the assessment of the risks involved in an acquisition. And, from the authorities' side, the enhanced due diligence is also interesting, as it increases the possibilities of revealing acts of corruption, given the benefits that the law offers – through the *leniency agreement* –, to the company that informs wrongdoings that may be identified within the context of an operation.

In this context, the execution of leniency agreements – through which companies acknowledge the practice of illegal acts and negotiate the penalties to be applied on them with authorities – comes to be an instrument available to the contracting parties, including for purposes of providing more safety to an M&A operation. Effectively, if well conducted – and if involving all competent authorities to punish that same fact –, such agreements may provide predictability as regards the extension of the consequences of the corruption act – which may come to be revealed to the potential buyer, within the scope of an *anti-corruption* due diligence.

If, on the one side, an asset involved in acts of corruption may, theoretically, be undesired as a result of the risk that this circumstance may represent to the acquirer, on the other side, this same *quality* will surely have a negative impact on its price – compared to an asset that does not present such risk. This way, knowing the risks, the acquisition of assets from groups involved with scandals may represent an opportunity of a good business, for which the execution of a leniency agreement, depending on the case, may be an interesting instrument.

And besides these alternatives, there are contractual techniques – some traditional and other uncommon until recently – to deal with these same risks (such as the use of indemnity clauses, escrow account, specific guarantees, possibility of undoing the business, etc.).

6.4 Conclusion

The phenomenon of hardening the repression against acts of corruption – of which Operation Car Wash and the Anti-Corruption Laws are manifestations – had impacts of extreme relevance on business life, altering the dynamics that traditionally defined (i) the parameters for accountability of managers and (ii) the risks involved with M&A operations.

As to the first point, to avoid generalized accusations against their executives, it is recommended that companies identify the risks inherent to their activities and, from there, reassess and, as the case may be, reformulate their internal structures (concerning compliance and governance, in general), with the purpose of improving the management and control of those risks. With that, they will certainly manage legal protection and, also, that of their managers, including the possible occurrence of undesired events.

In relation to the second point, the traditional due diligence and the use of anti-corruption clauses in the contracts ceased to be enough to provide the necessary safety to the buyers of assets – it being highly recommended to also carry out a specific due diligence with the purpose of verifying a possible involvement of the acquired company with acts of corruption, with the possible use of forensic investigations. In addition, contractual tools and other legal instruments (such as the execution of the leniency agreement) may be adequately customized so as to create a desired level of protection to the assets and their buyers – making it possible to take advantage of good business opportunities.

7. Reserve Based Lending in Brazil

Daniela Ribeiro Davila

Reserve Based Lending (RBL) is a financing mechanism internationally used by oil and natural gas companies to finance their activities, whose guarantees include, but are not limited to, proven reserves and production facilities. Backed by their reserves, companies leverage their balance sheets in order to raise funds to meet their capital requirements and repay such financing with proceeds from the sale of their production.

RBL started to be used in the United States in the 1970s, where legislation on the ownership of *in-situ* reserves is peculiar, since they belong to the license holder, but were soon adopted in the North Sea of the United Kingdom and Norway, with appropriate adaptations to the legislation of each country.

Projects usually structured in the form of project finance are suitable to RBL, involving fields already in production or where production is about to begin, and apply as a rule to non-recourse loan transactions and sometimes also to limited recourse loans.

The amount to be made available in a RBL structure is based and depends on several key factors, such as: (i) present value of future and expected production of the field in question, considering the volume of reserves; (ii) projection of the price of a barrel of oil; (iii) some discount rate; (iv) *capex* and *opex* costs; (v) taxes; (vi) government take; (vii) hedge values.

RBL is a mechanism that allows the oil company to recycle the capital invested during the exploration phase for use in the development and production phases, to anticipate its cash flow from the production phase of a given area for use in the exploration of another area and also to leverage acquisition of new assets in production.

Financial institutions working with RBL are prepared to take risks inherent to the oil industry, i.e., operator's performance, production risk (projected X achieved), fluctuations in oil quotation and risks related to their commercialization.

Effectively, the amounts made available in RBL are inversely proportional to the main risk pointed out above, that is, the production risk. Thus, the values are higher when the reserves are proven, are developed and already in production. In contrast, the values are lower when the reserves are proven and developed, but are not yet in production, and even lower when they are proven, but not yet developed.

It is evident, therefore, that RBL is a form of financing developed especially for the O&G industry and practiced by financial institutions with specialized knowledge of the sector.

RBL is a very valuable tool for a booming Brazilian O&G industry. It is even more relevant at this moment in the history of the sector, in which State policy points to encouraging new and medium-sized players to enter the market, and to a change in Petrobras' portfolio which, as a dominant player, impacts the sector as a whole. Thus, at a time when Petrobras has strategically decided to focus more on the areas with greater potential such as the Pre-Salt, and is selling various mature fields within a structured divestment program, the discussion about RBL is gaining special relevance and timeliness.

In Brazil, the fact that *in-situ* hydrocarbon reserves are private property of the Federal Government is not an obstacle to the use of RBL, since the amount of the loan is backed by the valuation of reserves, but the guarantees are on future production and payment of the loan occurs with the proceeds from the sale of production, which, after the measurement point, is the exclusive property of the concessionaire under the concession regime and must be shared with the Union at the rates determined in the Production Sharing Regime.

Currently in Brazil, structure financings in the O&G Sector already use guarantees of the RBL type, such as pledge/fiduciary assignment of oil and gas, controlled accounts, rights arising from concession contracts, receivables arising from off-take contracts; membership interests and shares, rights arising from joint operating agreements (JOAs) and consortium agreements, assignment of operating contracts, mortgage or fiduciary lien (chattel mortgage) of the production units (FPSOs, WHP, etc.).

However, the challenges faced by the parties – companies and financial institutions – are of a regulatory nature, in view of the interference of ANP in several aspects in the creation of guarantees (contractual prohibitions and need for prior consent by the Agency) and difficulties at the time of foreclosure on the collaterals in case of default.

It is necessary to create a set of rules that offer legal certainty and predictability in the creation and foreclosure of the guarantees. For this, ANP must clearly indicate minimum requirements and give the concessionaire the freedom to provide guarantees, respecting said minimum requirements.

It is also necessary to provide more agility and certainty to the preparatory procedures to foreclosure of the guarantees, that is, to provide mechanisms for temporary intervention in the project, such as the forced exchange of the concessionaire – the step-in right. Today, if there is a default, there is a need for approval of the assignment of rights by ANP (in any case, either in voluntary sale transactions – farm-out – or in cases of foreclosure due to default), which delays and endows the process with uncertainty, especially in the case of a highly specialized industry. At this point, the unanimous suggestion of market stakeholders in ANP Public Consultation on the subject was the creation of the figure of emergency operators previously approved by the ANP, who can temporarily assume operations in order to be compatible with the cure periods typical of financing contracts, preserving the assets and keeping operations in safe conditions. At this point, it is clear that a step-in mechanism, with emergency operators approved in advance by the Agency, would serve to align interests between ANP and the lenders.

Another relevant issue that needs to be addressed by ANP, especially with respect to older contracts, many of which are part of the Petrobras divestment program (mature fields), are the contractual provisions on the concessionaire's financial deterioration. In fact, such clauses have been improved in contracts for subsequent rounds, particularly with regard to the possibility of court-supervised reorganization. Thus, in said Public Consultation, it was suggested to the ANP to examine the application of the provisions of the current contracts to the previous contracts, upon request, on a case-by-case basis.

In short, the actions listed above regarding the identified critical points, which ANP needs to address for the full use of RBL in Brazil, not only support, but are fully in line with the principles of the CNPE Energy Policy (Resolution nº 17/2017), since only the large-scale financing of financial institutions, which understand and take the risk of the oil industry, will be able to leverage and enable the entry of small and medium-sized oil companies in this capital-intensive industry, with such specific risks.

PART III

THEMES RELATING TO O&G, OFFSHORE AND THE ENVIRONMENT

8. Farm-in in mature fields and its challenges

Thiago Luiz Pereira da Silva

8.1 Introduction

The oil and gas industry in Brazil has reached its first major cycle of maturing of exploration and production assets. The current mature fields, which at their peak of productivity were the *apple of the eyes* of the holders of their exploration and production rights, are gradually losing, together with their productivity, attractiveness to large exploration and production companies. However, for other economic agents, these assets represent an opportunity to diversify their revenue portfolio, as well as the entry point into the Brazilian oil and gas industry.

Concerning the importance of attracting new investors, we must keep in mind that maintaining the production of hydrocarbons from the mature fields means maintaining the continuity of the collection of royalties and taxes and a significant number of jobs, factors that are sensitive to the economic progress of the country. To this end, the Brazilian Government has taken commendable measures to foster economic interest in these assets, with special attention to Resolution nº 17 of 2017, issued by the National Energy Policy Council (CNPE).

Among such measures, the following stand out: i) the reduction of Local Content requirements in the new concession contracts for mature marine fields; ii) the unenforceability of Local Content in the new concession contracts for mature land fields; iii) the extension of Repetro, which benefits several of the assets used in the operation of these fields; iv) reduction of royalties on such fields; v) the reduction of the shareholders' equity required for the qualification of companies interested in acting as non-operators, encouraging the entry of new players in the industry; vi) incentives for participation of investment funds, promoting the participation of strictly financial entities as E&P concessionaires; vii) the implementation of reserve based lending, which will enable exploration

and production projects that do not support more aggressive financing; viii) the guidance provided by the National Energy Policy Council for the National Agency of Petroleum, Natural Gas and Biofuels (ANP) to encourage the extension of useful life of mature fields, among others.

As praiseworthy as the adoption the suggested measures might be, there are some obstacles created by the current regulation that need to be addressed to guarantee a real Brazilian oil and gas industry, with a significant number of agents and multiplicity of operators acting in each of the segments.

8.2 Forms of investment in mature exploration and production assets

Basically, there are two ways to invest in mature fields: i) the acquisition of total or partial participation in concessions in mature fields, through ANP bids, especially the recently implemented Permanent Offer; and ii) the purchase and sale, in whole or in part, of the participating interest held by a company in a particular field and the assignment of such interest in the relevant concession contract (*farm-in/farm-out*). In this second mode, the Petrobras Divestment Program deserves special mention, where more than one hundred concessions are being offered, with opportunities of different profiles.

In the one hand, investment in areas of the Permanent Offering has advantages such as the possibility of analysis of assets by potential investors (compared to the ordinary Bidding Round) without rush, since the submission of proposals, if carried out, will occur outside the competitive environment of a usual bid. On the other hand, in comparison with the farm-in in mature fields under operation, in this scenario there is reduced availability of information about reservoirs and their models, a greater need for investment in the development of the field and some exploratory (albeit small) risk.

On the other hand, the acquisition of assets via farm-in presents opportunities such as, for example, the significant potential increase of the recovery factor of the fields, the potential reduction of the costs of decommissioning estimated by the current operator through more efficient techniques and their mitigation over the extended period of useful life of the fields, the possibility of progressive acquisition of participation, with the transition of the scaled operation.

The acquisition of participating interest in currently operating mature fields is the form of investment that presents the greatest challenges for analysis by investors who wish to take over the operation (as opposed to investors who plan to be non-operators).

For the purposes of this study, we will focus on the analysis of these challenges, with suggestions for solutions to the current obstacles.

8.3 The extension of the useful life of the fields and the current dynamics for presentation of the Development Plans

In a mature field farm-in process, the economic viability of the projects usually depends on the increase in the recovery factor of the fields and the respective extension of the terms of the concession contracts. In turn, the extension of the term of the concession contracts is conditional upon the concessionaire demonstrating that the extension of the useful life of the fields is commercially viable, through the respective Development Plans.

From the operational point of view, the extension of the useful life of the fields requires the implementation of techniques whose innovative nature in the Brazilian scenario can generate uncertainties about its acceptability by the authorities, and the same can be said about the most advanced decommissioning techniques.

The current dynamics of the assignment of rights process within ANP does not allow the acquiring investor to remove uncertainties about the viability of its project (and its projected Development Plan) prior to the approval of the assignment of rights, at which time such investor will already have fully assumed before ANP the commitment to fulfill the obligations of the concession contract.

This is because the first step of the assignment process is the submission of the assignment request by the assigning concessionaire, jointly with the relevant documents, for analysis and approval by the ANP. It is only after the analysis and approval of the request for assignment of rights that the acquiring concessionaire is allowed to present its Development Plan (which must be done one hundred and eighty days after the approval of the assignment of rights).

At the moment, the investor, already a concessionaire, cannot *give up* the assignment if its proposed Development Plan is not approved by ANP, remaining obliged to comply with the previously approved Development Plan, including its decommissioning. It shall be noted that such previous Development Plan was submitted by the selling concessionaire and may not have been drafted with the same care and effort than the buyer's Development Plan. That is, in the current regulatory framework, potential investors are only certain that the concession contracts will have their deadlines extended and that their plan for development and extended field production is acceptable once they have fully assumed the obligations and risks of the contracts.

A business solution to this impasse, but with a significant risk to the assigning concessionaire, is for the selling concessionaire to submit the Development Plan planned by the potentially acquiring concessionaire for analysis and approval by the ANP prior to the submission of the request for assignment of rights. There are some considerable obstacles to this solution. From a technical operational perspective, there is the challenge generated by the fact that, before assuming the operation of the field, the acquiring concessionaire will not hold the necessary information to present a solid and definitive Development Plan.

From the perspective of the assigning concessionaire, if the Development Plan sought by the acquirer is approved by the ANP and the farm-in operation between the parties does not go into effect, the assigning concessionaire will have undertaken to comply with the Development Plan sought before the ANP, whose approval of the Development Plan is binding.

Another solution that depends on the regulatory change in the assignment process, among other possible challenges, is the creation of a procedure that allows the potential buyers to send a teaser of the Development Plan designed for a given field, to be analyzed by the ANP and with protection to the confidentiality of the plan. The confidentiality of the teaser is essential because, since the farm-in has not yet been completed, publishing the content of the teaser Development Plan may have extremely harmful impacts for the transaction.

In this suggested scenario, ANP could point out possible the necessary adjustments needed for approval of the teaser Development Plan, guaranteeing that ANP's technical and safety premises will be respected. Once the needs for adjustment are indicated, the parties involved in the farm-in may better evaluate the required investment for development of the fields, while also

removing uncertainties about the feasibility of the project. Although such dynamic represents new administrative costs related to the analysis by ANP, if the potential acquirer pays the administrative cost for this analysis, it will be a fair trade for eliminating the existing uncertainties.

8.4 Lack of objectivity in the regulation on decommissioning

It is not possible to discuss investment in mature fields without addressing the responsibilities for decommissioning that will arise for investors. It is important to emphasize that only with the assurance that the terms of the concession contracts will be extended will the project have the capacity to be financially viable and incorporate the significant costs of the decommissioning of a mature field, which will be incurred during the new and extended contractual term.

In this sense, it is worth remembering that CNPE, in its Resolution 17 of 2017, instructs ANP to take measures so that the "decommissioning of the installations is only carried out at the end of the useful life of the fields, avoiding its premature occurrence". To do this, it is essential to ensure that the extension of field life will be achieved without major obstacles.

Regarding the materiality of the decommissioning costs, practical experience has shown that the mature field projects currently being analyzed in Brazil have their main economic factor as decommissioning costs, and the commitment to take responsibility for the costs of decommissioning has been a substantial part of the value composition of the acquisition proposals.

In the regulatory area, the matter is currently regulated by ANP Resolutions 27 and 28 of 2006, quite general rules, which do not elaborate in detail on the objective evaluation criteria used by the ANP to indicate whether a decommissioning project will be considered acceptable to the Agency. Due to the absence of such criteria, we have a scenario similar to that generated by the uncertainties about the acceptance of the Development Plans for the mature fields and their respective extension of the field life mentioned in the topic above.

The aforementioned Resolutions are under current revision of the ANP, and it is crucial that objective criteria of evaluation for the decommissioning be established in this revision. However, while the revision of the Resolutions is critical, an urgent solution is needed to

enable current operators as well as potential investors to assess what will be acceptable to regulators for field decommissioning.

On the one hand, the lack of objectivity of the criteria makes the measurement of decommissioning costs to be assumed by potential investors almost impossible. Questions such as "what will be considered as acceptable risk by the authorities", "what types of installation may remain on the seabed", "even if it is decided to act conservatively, what measures are necessary to prove that a certain risk is acceptable" are left unanswered during an investment assessment, and, remaining unanswered, investment is discouraged. On the other hand, without clear standards, current operators are being impeded to efficiently plan for a potential extension of field life, which would allow for dispersion of decommissioning costs over the additional concession period.

Similar to the suggested submission of teasers Development Plans, a new procedure should be considered to allow potential purchasers to send their planning for the decommissioning of the field for analysis by the ANP, with no binding effect, including guarantees to be provided. This would allow the emergence of creative and sustainable models from technical, operational and financial points of view. In this scenario, ANP would continue to have all the capacity to evaluate the necessary adjustments to approve the projects contained in the teasers, at the same time allowing the pricing of the responsibilities assumed by the decommissioning.

It is also necessary to expand the forms of guarantee acceptable to ANP for decommissioning, since the currently accepted guarantees represent significant financial costs and do not fit into the narrow economic margins of these projects.

From the technical-operational point of view, perhaps the best method for the ANP to establish a reasonable objective criteria is the comparative one, based on the world experience in the decommissioning of areas. It is relatively simple to consult[1] approved decommissioning projects or under review by regulators globally and certainly the ANP is entitled to request such information from other regulators around the world. This consultation will provide methods for Brazilian entities to consult the best techniques in the world, checking what is feasible (and therefore practical) and successful in the industry. Indication

1 For example, on the British Government website, it is possible to consult, in full, all the decommissioning projects under review and already approved since 2006. Available at: <https://www.gov.uk/guidance/oil-and-gas-decommissioning- of-offshore-installations-and-pipelines>

of certain successful projects in other regions of the world as benchmarks by regulators could be a quick and efficient solution to the current urgent scenario, while detailed regulation is under development.

8.5 Conclusion

Despite the incentives and fostering measures that exist today, projects in mature fields have marginal economic conditions. Ensuring its economic viability is a challenge that needs careful planning and the willingness of regulators to promote business. The entry of new economic agents into the Brazilian oil and gas industry, a goal so desired by the ANP, will only be possible with the adoption of creative measures and flexibility of the procedures currently in force, which were designed for economically robust companies with solid financing capacity. With due effort from regulatory agencies, there are rewarding business opportunities for investors willing to accept the challenges, the greatest beneficiary of which will always be Brazilian society.

9. The role of the Brazilian Federal Accounting Court (TCU) in the Oil & Gas industry

Cláudio R. Pieruccetti Marques

It is undeniable that the generation of energy, conventional or alternative, is strategic for the development of any nation, and Brazil is not an exception to this rule. Due to its natural characteristics, the exploration and production of petroleum and its derivatives is gaining special relevance in our country, whether examined from the strategic point of view, or even from the economic-financial aspect.

In the 1990's, this fact, together with foreign experience with regulatory agencies, led the Federal Government to create some agencies designed to regulate sectors considered to be strategic. Regarding the oil & gas industry, Law nº 9,478, of August 6, 1997, created the National Energy Policy Council, which is responsible, for example, for "defining blocks to be object of concession or production sharing[1]."

Law nº 9,478/1997 also created the National Agency of Petroleum, Natural Gas and Biofuels (ANP), conferring upon it the responsibility to "promote studies aimed at demarcating blocks for the purpose of granting concessions or contracting, exploration, development and production activities under the production sharing regime"[2], "regulate the execution of geological and geophysical services applied to oil exploration, aimed at surveying technical data intended for sales, under a non-exclusive basis"[3] and further "preparing tender protocols and promoting bid rounds for the concession of exploration,

1 Wording of item VIII, of article 2, of Law nº 9,478/1997.

2 Wording of item II, of article 8, of Law nº 9,478/1997.

3 Wording of item III, of article 8, of Law nº 9,478/1997.

development and production activities, signing relevant agreements and verifying their execution;"[4].

In the oil & gas sector, it is these two agencies – or at least it should be them – that exercise the functions of supervision and regulation attributed to the Federal Government by the first part of article 5 of Law nº 9,478/1997[5]. However, the complex model of dividing up the responsibilities established in the Federal Constitution, enacted in 1988, resulted in these not being the only entities that perform supervisory activity in the sector, which results, at times, in generating a setting of legal uncertainty for the investors.

Under the terms of the provision in article 20, item IX, of the Federal Constitution, petroleum and natural gas are assets that belong to the Federal Government. The search for and extraction of such resources constitute a monopoly, as provided for in article 177 of the Constitutional Charter, which in § 1 further makes provision for the possibility of contracting state- or privately-owned companies for the practice of such activities, "through concession, authorization or contracting under the production sharing regime", as stated in the final part of the aforementioned article 5, of Law nº 9,478/1997.

By using any one of the mechanisms made available by Law nº 9,478/1997 for the exploration of petroleum and natural gas, the Federal Government may outsource the *administration* of its own assets, assigning to the Federal Accounting Court (TCU), the role of supervisory body, to which is attributed, by item II of article 71 of the Federal Constitution, the competence to "evaluate the accounts of the administrators and others persons responsible for public monies, assets and values of the direct administration"[6].

Within the scope of this jurisdiction to supervise the use of public assets and resources, the Federal Accounting Court is granted the prerogative to suspend the execution[7] of the acts subject to its supervisory power, or in other words, to

4 Wording of item IV, of article 8, of Law nº 9,478/1997.

5 "Art. 5 The economic activities stated in article 4 of this Law will be regulated and inspected by the Union, and may be exercised, upon concession, authorization or contracting under the production sharing regime, by companies organized under Brazilian law, with headquarters and management in the Country."

6 Initial part of item II of article 71 of the Federal Constitution.

7 See item XI of article 71 of Law 9,478/1997.

suspend the execution of the "acts from which may result revenue or expense, practiced by the bodies responsible and subject to its jurisdiction"[8].

Under the terms of the provision in article 276, § 2, of TCU Resolution nº 246, of November 30, 2011[9], the Internal Regulations of the Federal Accounting Court, the TCU can even grant a provisional injunction with the object to preventively suspend the challenged act until a definitive decision is taken on the matter.

Specifically with regard to the oil & gas sector, the bid rounds under the responsibility of the ANP are supervised by the Federal Accounting Court according to the guidelines established in Normative Instruction nº 27, of December 2, 1998, that deal with concessions, permissions and authorizations of public services.

In its article 7 onwards, Normative Instruction nº 27 divides the supervisory procedure into 4 (four) stages, the first of them being the prior or concomitant analysis of a:

> "summary report on the technical and economic viability studies of the project, with information about its objective, area and term of concession or permission, budget of the works performed and yet to perform, date of reference of the budgets, estimated cost for providing the services, as well as about any sources of alternative, complementary, accessory revenues and those accruing from associated projects."[10]

So, at the beginning of the year 2018, the ANP published the Request for Proposals of the 15th Bidding Round for onshore and offshore blocks, for granting of concession contracts for oil and natural gas exploration and production activities, which included Blocks S-M-645 and S-M-534 (outside of the pre-salt polygon) and, simultaneously, of the 4th Round under the Production Sharing

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8 Final part of article 41 of Law nº 8,443/1992, the Organic Law of the Federal Accounting Court.

9 "Art. 276. The Full Court, the rapporteur, or, in the case of article 28, item XVI, the President may, in case of urgency, based on fear of serious harm to the treasury or to the rights of others or the risk of ineffective decision on the merits, ex officio or upon request, adopt a precautionary measure, with or without the previous hearing of the parties involved, in order to determine, among other measures, the suspension of the contested act or procedure, until the Court decides on the merits of the question raised, pursuant to article 45 of Law nº 8,443, of 1992."

10 Text of article 7, item I, paragraph 'a', of Normative Instruction nº 27/1998.

System, encompassing the Block of Saturno (inside the polygon), all of them located in the Area of Saturno, in the Santos Basin.

Analyzing the documentation relating to the 15th Round initially sent by the ANP, the Federal Accounting Court verified the absence of relevant documents, which led to the request for submission of complementary documentation, and based on this reply the Federal Accounting Court stated (i) that:

> "the risk of unitization between the areas to be contracted separately implies, in addition to non-compliance with existing legal and regulatory regulations, economic risk, for it has the potential to interfere negatively in the very attractiveness of the part of Saturno that remained in the 4th Round of Bidding"[11]

And, (ii) "another relevant risk of a regulatory nature, created by the decision to offer under distinct auctions and systems, two areas for which the technical information existing today indicates quite clearly the need for unitization."[12]

In light of this, it ended up by determining "the preventive suspension of the procedures of public offering of blocks S-M-645 and S-M-534, in the scope of the 15th Round of Bidding, until the Court makes a definitive decision as to the merits of the irregularities indicated"[13], which generated an enormous impact – negative – on the market, not only by the interference of the TCU, but also by the fact that it occurred on the eve of the scheduled date for the auction.

Even though we have given a general panorama of the supervisory activity of the Federal Accounting Court in the oil & gas sector, this type of measure brings to light at least two important questions from the legal point of view.

The first of them relates to the possible questioning about the applicability, or not, of Normative Instruction nº 27/98 to the bid rounds for the exploration and production of natural gas and oil fields, since it regulates the supervision of the concessions, permissions and authorizations of *public services*, a category in which it can be sustained that the exploration and production of oil and natural gas deposits do not apply.

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11 This justification appears in item 8 of the report of Appellate Decision nº 672/2018 – Full Court (Case TC nº 000.016/2018-7).

12 This, in turn, can be read in item 9 of the same report.

13 Item 9.1 of Appellate Decision nº 672/2018 – Full Court.

Even though it is not possible to find a precise definition of *public service* in the Brazilian legal system[14], article 175 of the Federal Constitution[15] makes it apparent that the offer of a certain *service* to society is inherent to the concept of a public service, which one does not identify in the economic exploitation of the activity of extraction of petroleum and natural gas deposits[16].

Even if it is alleged that the fruits of this activity will eventually be used for the defrayal of various benefits to be delivered by the State to society, it is certain that the exploitation of the activity itself does not include any direct benefits. There is no inherent service that is directly made available to the population.

This argument is also corroborated by the fact that the sole paragraph of article 175 of the Federal Constitution[17], when delimiting the scope of the law that should be enacted to regulate the concessions and permissions of *public services* (which came to be Law nº 8,987/1995), referred to items that hold a direct relationship with the users, such as, for example, *users rights*, *tariff policy* and *suitability of the service*.

In any case, it cannot be ignored that the Federal Accounting Court, based on the assumptions that (i) the Union is the owner of the petroleum and natural gas deposits and, (ii) the provision contained in article 2, § 1, item 'a', of Law nº 9,491/1997, which deals with the National Privatization Program, considers privatization as "the transfer or granting of rights over movable property and real estate of the Union, under the terms of this Law", means that Normative Instruction nº 27/98 applies to bidding for petroleum and natural gas blocks.

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14 Let us read what Vlamir da Rocha França says (*In*: *Comments on the Federal Constitution of 1988*. Coordinators: Paulo Bonavides, Jorge Miranda and Walber Moura Agra. Rio de Janeiro: Forense, 2009, p. 2002).

15 "Article 175. It is incumbent upon the Government, as set forth by law, to provide public utility services, either directly or by concession or permission, which will always be through public bidding."

16 This is also reinforced by the provision in article 2 of Law nº 8,987/1995, which when defining concession of a public service and permission of a public service similarly refer to a provision that must be delivered to society.

17 "Sole paragraph. The law shall provide for:
I - the operating rules for the public service concession- or permission- holding companies, the special nature of their contract and of the extension thereof, as well as the conditions of forfeiture, control and termination of the concession or permission;
II - the rights of the users;
III - tariff policy;
IV - the obligation of maintaining adequate service."

In view of the above, it is recommendable that those interested in participating in such negotiations verify the compliance of the ANP, with the rules contained in Normative Instruction nº 27/1998, so as to reduce the risks that, on the eve of an auction, or even after its completion, it may be caught by surprise by a decision that might come to suspend the business or even annul it, which would be totally undesirable, not only for the legal inconvenience, but, above all, because of the high investments that this type of business usually demands.

The second most important issue concerns the scope of the supervisory jurisdiction vested in the Federal Accounting Court.

As is known, while the history of the regulatory agencies in the country may have had its start at the time of the creation, among others, of the Brazilian Coffee Institute (IBC) and of the Securities Commission (CVM), their profusion took place in the nineties of the last century with the advent of the National Privatization Program (PND).

For each one of the sectors in which the withdrawal of the direct involvement of the State in the economy was implemented, an independent entity was created, endowed with administrative and financial autonomy, without which its work – of a technical nature – could be compromised.

So then, the regulatory agencies, regardless of their technical, administrative and financial autonomy were constituted under a special self-governing system, and certainly, this was no different with the ANP[18].

It is worth mentioning that the ANP, while being a member of the structure of the federal public administration, specifically, the Ministry of Mines and Energy, performs normal administrative acts, which, by the way, generate revenue for the public treasury, such as the hiring of personnel, the lease or purchase of properties to serve as headquarters, etc. For such acts, it seems that there is no doubt as to the possibility of an outside control by the Federal Accounting Court[19].

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18 "Art. 7 It is herewith established the National Agency of Petroleum, Natural Gas and Biofuels - ANP, as an integral entity or indirect federal administration, subject to autarchic regime, as a regulatory body for the oil, natural gas, by-products and biofuels industry, linked to the Ministry of Mines and Energy."

19 This is what Alexandre Santos de Aragão says: "There is no doubt that the regulatory agencies, as the autonomous government agencies that they are, must render accounts to the Federal Accounting Court with regard to the public funds they spend (art. 70, CF)". (*In: Agências reguladoras e a evolução do direito administrativo econômico* (Regulatory Agencies and the Evolution of Economic Administrative Law). Rio de Janeiro: Forense, 2009, p. 339).

The real problem lies in the supervisory activity of the activities of the regulatory agencies, since, as Marianna Montebello Willeman[20], Counselor of the Accounting Court of the State of Rio de Janeiro warns, it was: "as a form of assuring credibility for the new model of state regulation of the economy" that:

> "the regulatory agencies were endowed with a special legal system that recognizes their administrative and financial autonomy, as well as their independence to be able to operate free from political injunctions before the regulated segments and before the granting authority itself."

In our opinion, by the way, the technical autonomy of the regulatory agencies highlighted by the Counselor, which becomes a genuine *shield* in relation to the granting authority, could – or should – extend to all the entities of the granting authority. Moreover, not just it, but also all the other bodies and entities of the Public Administration, even though they may be of other Powers.

This, in fact, is the guarantee that the State should give to the *market* that its withdrawal from direct action in the economy is effective.

This is the opinion of the Supreme Court Justice, Luís Roberto Barroso[21] when stating that "the institution of a special legal system aims at preserving the regulatory agencies from undue interference, including and above all else, as indicated by the State and its representatives".

Analyzing a real case involving the Public Services Agency of the State of Rio de Janeiro, also acting as State Attorney, he asserted[22], even more vehemently, the limitation of the outside control on the part of the Accounting Court in the work of the agency, stating that "the Accounting Court cannot question political/administrative decisions of the Asep-RJ nor request spreadsheets and reports issued by the Agency or by a Concessionaire, which specify supervision and procedures adopted in the execution of the contract".

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20 *In: Accountability democrática e o desenho institucional dos Tribunais de Contas no Brasil* (Democratic Accountability and the Institutional Design of the Account Courts in Brazil). Belo Horizonte: Fórum, 2017, p. 300.

21 Agências Reguladoras. Constituição, Transformações do Estado e Legitimidade Democrática. *In*: MOREIRA NETO, Diogo de Figueiredo (Coord.). *Uma avaliação das tendências contemporâneas do direito administrativo* (An Assessment of Contemporary Tendencies in Administrative Law). Rio de Janeiro: Renovar, 2003, p. 174-178.

22 Opinion nº 05/1998 – LRB, handed down on December 10, 1998, in the records of Administrative Case nº E-14/35468/1998.

However, legal uncertainty becomes evident in the understanding of some of those who, like Alexandre Santos de Aragão[23], affirm that the Federal Accounting Court "can indeed control such acts of regulation, since, immediately or indirectly, acts of regulation and supervision over public service concessionaires are reflected in the Treasury".

In practice, the decisions of the Federal Accounting Court, at least in theory, have been sustaining that the supervision finds its limit in the jurisdiction of the regulatory agency itself. In this sense, Appellate Decision nº 2071/2015[24] determined that "the work of the external control in the end activities of the regulatory agencies is limited to the supervision of a secondary nature, respecting the limits of operation and functional autonomy of those entities"[25].

In another decision, reported by the Justice of the Federal Accounting Court, Augusto Nardes[26], observed that "in the supervision of the end activities of the regulatory agencies, the TCU must not substitute the bodies that control it, nor establish the content of the act of jurisdiction of the regulatory body, determining upon it the adoption of measures".

Considering the topic from an exclusively theoretical point of view, the Justice of the Federal Accounting Court, Benjamin Zymler[27] points out that:

> "the role of the Court in the control of the concessions, permissions and authorizations of a public service is not to be confused with that of the regulatory agencies. After all, the TCU supervises the work of the agency, aimed at gauging its compliance with the legal system and with the guidelines issued from the competent authority."

In our opinion this seems to be the most correct position, even by virtue of the principle of efficiency, included in article 37, *head provision*, of the Federal

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23 *In: Agências Reguladoras e a evolução do direito administrativo econômico* (Regulatory Agencies and the evolution of economic administrative law). Rio de Janeiro: Forense, 2009, p. 340.

24 Full Court, Just. Rap. Vital do Rêgo.

25 This understanding had already been set out before when rendering Appellate Decision nº 2,138/2007 – Full Court (Just. Rap. Benjamin Zymler).

26 Appellate Decision nº 715/5008 – Full Court (Just. Rap. Augusto Nardes).

27 *In: O controle externo das concessões e das parcerias público-privadas* (The External Control of Concessions and Public/Private Partnerships). 2nd ed., Belo Horizonte: Fórum, 2008, pp. 164/165.

Constitution, since it would not make sense that two entities belonging to the structure of the State perform supervision with the same objective.

Even though such decisions may be in consonance with the position that:

> "in principle, the Federal Accounting Court must follow the standards of self-containment, recognizing with humility and prudence, that it is not up to them to formulate regulatory choices in substitution of the agencies, particularly with regard to technical aspects properly and specifically belonging to the regulated segment"[28]

it is possible to identify in the precedents itself of the Federal Accounting Court a decision that apparently creates an exception to this *rule*.

In fact, the Appellate Decision nº 602/2008 – Full Court[29], clearly says that:

> "the jurisdiction of the Court is not suppressed to determine corrective measures to the act practiced within the sphere of discretion of the regulatory agencies, provided that it is defective in its attributes, by way of example of competence, form, purpose or, further if the determining and declared motive is non-existent. In such cases and if the irregularity is severe, it can even determine the annulment of the act."

As far as the exception for the control of the formal legality of the regulatory decisions is concerned, such as occurred in the aforementioned case, it finds support in the voice of the specialists[30] and may even be supported by precedents from the Federal Accounting Court itself[31], the fact is that it ends up serving as grounds for substantially more profound interferences.

In the year 2003 Decision issued by the Full Body of the Federal Accounting Court determined that National Agency of Petroleum, Natural Gas and Biofuels (ANP) should propose other mechanisms of assessment of economic/financial viability to substitute the Technical Feasibility Study for the choice of blocks

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28 WILLEMAN. Marianna Montbello. *In: Accountability democrática e o desenho institucional dos Tribunais de Contas no Brasil* (Democratic Accountability and the Institutional Design of Federal Accounting Courts in Brazil). Belo Horizonte: Fórum, 2017, pp. 302/303.

29 Just. Rap. Benjamin Zymler.

30 WILLEMAN. Marianna Montbello. *Ibid*, p. 303.

31 This understanding can be inferred from the following decisions: Full Court Decision nº 351/1999, Full Court Decision nº 232/2002, Appellate Decision nº 2,249/2007 – Full Court.

to be included in future bidding rounds. Look at the terms of item 9.2.2 of the conclusions of the decision:

> "9.2.2) assess the usefulness of the Technical and Economic Feasibility Study as an instrument for the selection of blocks for the future rounds of bidding, proposing other mechanisms of verification of the economic/financial feasibility, if the study currently prepared is not being effectively used in the decision-making about the blocks to be offered out for bid."[32]

Returning to Appellate Decision nº 672/2018, which partially suspended the auction of the 15th Round of Concession for exploration of petroleum blocks, these were the grounds that, apparently, guided the decision. Item 5 of the report of Decision nº 672/2018 – Full Court specifically indicated that:

> "the preliminary instruction (item 37) highlighted that during the analysis of the package of documents initially submitted by the Regulatory Agency, this Technical Unit observed the absence of relevant information, which should have been sent for examination of the First Stage of the granting process, in compliance with item I, of art. 8, of TCU NI 27/1998."

However, when carefully analyzing the recent and striking decision of the Federal Accounting Court, it is inferred that the formal justification, and according to some, the correct one, in reality masks an interference in the regulatory activity in itself.

Thus it is said, initially, in view of the simple verification that, as stated in the same report, the late and incomplete sending of the documentation required by Normative Instruction nº 27/98 was in some way suppressed by the Accounting Court, which not only sent official letters to the ANP requesting the forwarding of the missing information (Official Letter 1-55/2018 – TCU/SeinfraPetróleo, of March 2, 2018 and Official Letter 2-55/2018 – TCU/SeinfraPetróleo, of March 6, 2018), but also determined the previous notification of the agency and of other bodies due to the decision that would come to be rendered in a precautionary measure.

So much so was the formal failure suppressed that the information presented by the ANP in response to the communications from the Federal Accounting

32 Appellate Decision nº 68/2003 – Full Court (Just. Rap. Ubiratan Aguiar).

Court allowed a more – in-depth consideration – of the request for the provisional remedy, which included a pronouncement about aspects pertinent to the eminently regulatory judgment.

A certain excerpt of the leading vote, the Federal Accounting Court explicitly issues a value judgment about a certain criterion used by the ANP, asserting that it does not comply with that adopted by the Court itself.

> "203. Another aspect revealed is that the ANP understands that the vision of the economic analysis must be very short term, that is: only at the horizon of the auction and not that of the project as a whole. Clearly, it considers overlooking the future curves of revenue of the government take. Which does not seem compatible for the vision of a regulatory agent and with the current legislation. At least, it is not compatible with the supervisory criteria of authorization applied by the TCU."

Although the body of the judgment contains several caveats that the Court was not in that act replacing the ANP in the decision that adopted a certain modelling for the granting of the right of exploration of petroleum and natural gas deposits, always justifying its interference based on formal failures (absence of grounds for the option, for example), this reason does not find support in the investigation of the case, which depends on the information rendered not only by the agency, but also by the Ministry of Mines and Energy and the National Energy Policy Council.

Greater evidence of this is on pg. 12/20 of the Appellate Decision given by the Federal Accounting Court, in which a detailed description of the clarifications provided was given and the corresponding analysis of the Federal Accounting Court about the justifications presented by the ANP through the referred to bodies.

Therefore, it is untruthful to accredit the decision of the Federal Accounting Court to formal failures that, having been supplied, cannot serve – as in fact they did not serve – as an impediment for the analysis of a certain matter, principally if of strategic relevance to the country.

In summary, what is perceived is that the practice of the Federal Accounting Court in supervising the oil & gas sector is that of performing control of the merits of the regulatory decisions, even though under the justification of the existence of formal failures, like the absence of grounds, when disagreeing with the positions of the Federal Accounting Court.

For this reason, in view of the huge investments in the oil & gas sector at each round of bidding for blocks, it is recommendable that all the precautions necessary be adopted for verification of the compliance of the procedures adopted by the ANP with the *guidelines* of the Federal Accounting Court, to avoid surprises such as the total or partial suspension of a round of bidding or even the declaration of annulment of a contract already signed.

10. Guarantees for Offshore Financing Projects

Marina Ferraz Aidar

10.1 Introduction

As Daniel Yergin openly and bluntly stated, in his famous phrase about the oil and gas industry "[n]o other business so starkly and extremely defines the meaning of risk and reward – and the profound impact of chance and fate"[1].

According to sector estimates, the oil and gas industry in Brazil is expected to move R$ 1.28 trillion by 2030, with the high level of specialization and technology of the equipment and vessels used in the offshore gas and oil exploitation and production activities, as well as maritime and logistical support activities, contributing to this surprising amount.

Although once the enterprise is successful it might offer an elevated yield to the investor, significantly compensating for the investment made, the initial phase of these projects involves very high investments and risks. Added to this is the fact that, many times, the assets used in the drilling, support and production activities need to be built or adapted for specific projects, raising the costs and risks of the project.

To reconcile these two factors, risks X investments in the superlative, and provide the entrepreneur with attractive financing rates, structured financing transactions, in the Project Finance mode, have been a recurring alternative to make the exploitation and production of oil and gas feasible. The major characteristic of this type of transaction is the use of the revenues generated by the exploration of the project for the repayment of the financing in the long term. For it to be possible, the other essential characteristic of this financing mode is the construction of a solid packet of guarantees.

In a Project Finance transaction, the lender (individually or in a group, as we will see later), relying on a well-grounded business plan, faces a scenario in which they

1 YERGIN, Daniel. The Prize: The Epic Quest for Oil, Money & Power. 2011, p.16

must spend financial resources at a time when there is no generation of revenue by the entrepreneur and, in many cases, when the revenue will take a couple of years or more to start being generated, as frequently occurs in the cases of construction of vessels.

There is, therefore, the need for a package of robust guarantees that may mitigate the risks of construction and failure of the enterprise. It is in this scenario that what Graham D. Vinter[2] defines as a defensive profile of the packet of guarantees is born, for, as the continuance of the project is the pillar of a Project Finance, it is indispensable that the lender may be able to intervene therein, if necessary, under a scenario of stress. The manner by which this occurs is what we will address in this chapter.

10.2 Legal regime of guarantees in Brazil

Brazilian law classifies guarantees as personal guarantees and security interests. Personal guarantees are those given by a third party, who may be foreign to the main relationship or not, and who is responsible for paying the debt, by means of an accommodation paper or a suretyship. Security interests, in their turn, which are those that consist of encumbering one or more assets to ensure compliance with the obligation, may be established by means of mortgage, pledge and antichresis, these being the classical forms of security interests provided by our legal system; or further, the secured fiduciary assignment , more recently included in the list of security interests.

This way, even governed by a different legislation in the main contract, the Project Finance transactions in Brazil usually have a guarantee package that combines personal guarantees and security interests.

10.3 Main security interests in offshore projects

10.3.1 Credit rights

As said above, considering a structured long-term financing, the revenues from the exploitation of oil and gas is the heart of the project, which will allow for its longevity. As it is financing aimed at ensuring the performance of a project that

2 VINTER, Graham D. *Project Finance*. 2006, 3rd ed.

has already been contracted, the big asset of the lender is to obtain the contracted revenue as its payment guarantee. In this sense, the main guarantee to be given to the lender are the credit rights deriving from the sale of the product obtained.

In Brazil, the most used institution is the fiduciary assignment, the legal grounds of which were already addressed in our first primer, so that in this book our focus will be on the mechanism to operationalize this guarantee.

Differently from other assets which enable the individualization and identification of the collateral, as in the case of a vehicle or real property, for instance, the financial resources are not subject to identification (as in the popular saying *money has no stamp*). Thus, such guarantees involve the opening of bank accounts with restricted transactions, subject to a specific contract, whether apart or not from the fiduciary assignment contract, which relates to the financial flow of the project.

This contract may provide for simple or complex structures of bank accounts using the waterfall concept, by which, after the first account is fed, the resources must be deposited in another one and so on, until the eventual balance is released to the debtor in an account with free transactions.

For this structure to work, it is imperative that each and every resource obtained by the debtor be deposited in a central account subject to a fiduciary assignment. From then on the depository bank will be responsible for transacting the resources.

Such accounts receive not only the credit rights arising from the operation of the projects, but also those resulting from payments made by insurance companies in case of loss and other credit rights resulting from the project.

This control over the financial flow is one of the major foundations of the whole Project Finance structure. This allows the lender to identify and access the resources in case of an eventual need to foreclose this guarantee, and also to monitor the entry of financial resources into the accounts, as well as their use during the financing term. This way, it is possible to foresee an event of nonperformance or other potential stress situation and request the debtor to take (or even directly take, in certain cases) the preventive or remedial measures so as to avoid a problem that might impact the project.

10.3.2 Shares or membership interests of SPE

The Project Finance mode implies the need to establish a specific-purpose company (SPE) for the exploitation of the project. Thus, the SPE

is not contaminated by the risks of the activities of its shareholders or affiliated companies, segregating the duties and obligations inherent to the activities of the undertaking.

If the revenues are the heart of the project, it can be said that the shares or membership interests of the SPE are its soul. It is through interest in the SPE that the decisions defining the course of the project are made.

Therefore, besides the traditional function of establishing security interest on such shareholding (which may occur by means of pledge or fiduciary assignment enables the use of the foreclosure resources for settlement of the debt), the encumbrance over the interest on the SPE allows for direct interference in the project. That is because the contract establishing the security interest may both provide that certain subjects be resolved in agreement with the creditor[3] and also allow that, under a stress scenario, this shareholding be transferred, in an extrajudicial sale, to another company chosen by the lender.

10.3.3 Vessels

The security interest on the vessel is another important instrument of guarantee in the Project Finance transactions for two reasons: one because, when performed along with the assignment of the main contracts, it enables the continuance of the project by a third party indicated by the lenders, and two, because the vessel, as a rule, is the asset with the highest value in the project and, therefore, an important resource to obtain the payment of the debt.

In structured financings, the vessels are usually encumbered through mortgages. Mortgages of vessels under the Brazilian flag must be registered before the maritime court. On the other hand, mortgages of vessels under foreign flags are usually registered before the country of the flag and, in Brazil, before the Notary Office for Registry of Bonds and Documents (RTD).

It is not possible to address vessel mortgages in Brazil without mentioning the great discussion held in recent years concerning the recognition of foreign mortgages in Brazil.

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3 Law 6,404/1976: "Art. 113. Pledging the share does not prevent the shareholder from exercising their right to vote; however, it shall be lawful to establish, in the contract, that the shareholder may not, without consent from the pledgee, vote on certain resolutions. Sole paragraph. The creditor guaranteed by the fiduciary assignment of the share may not exercise their right to vote; the debtor may only exercise it under the terms of the contract".

The stir resulted from the decision of the Court of Appeals of São Paulo, which understood that a mortgage on an FPSO vessel did not have the conditions to be recognized under Brazilian law. Among the reasons claimed for the non-recognition was the fact that the country of the vessel's flag and the place where the mortgage was established was not a signatory of the Brussels Convention of 1926, validated in Brazil by means of Decree 351/1935, and the Bustamante Code, internalized by means of Decree 18,871/1929, which would be the relevant legal instruments for governing the validity of foreign mortgages in Brazil.

This discussion was taken to the Superior Court of Justice, which decided, by the end of 2017, for the validity of the mortgage, reducing the huge legal uncertainty started by the former decision of the Court of Appeals of São Paulo.

Besides the burdening of the vessel through mortgage, it is worth emphasizing the possibility of establishing the fiduciary assignment of the asset as part of the lenders' guarantee package[4].

As everyone knows, fiduciary assignment is a type of guarantee that is established by transferring the terminable property of the asset to the (fiduciary) creditor, while the direct ownership of the asset remains with the (fiduciary) debtor. This situation lasts until the obligation is settled, when the fiduciary debtor recovers full ownership of the asset.

It should be mentioned that, while in the mortgage the creditors have a security interest on the vessel, in the fiduciary assignment what is observed is that the creditor has the indirect ownership of the asset, with experience having shown that the procedure to enforce the fiduciary assignment is, as a rule, faster than the procedure to enforce the mortgage.

10.3.4 Rights of the main contracts

Another essential guarantee for the continuance of the project is the conditioned assignment of its main contracts, which involves the contract with the client, the main source of resources for the project, the vessel construction

4 It is worth remembering that the units used in offshore activities are equated with vessels and, as such, are fictitiously deemed as immovable properties, and may be both subject to mortgage as well as to fiduciary assignment of immovable properties.

or conversion contract that, if applicable, enables the existence of the project, and the contracts with the major subcontractors.

Sometimes these contracts have clauses making it mandatory for the other party to consent to the performance of such assignment, which makes not only the sending of assignment notices, but also the consent request mandatory.

It is worth mentioning that, when the client is Petrobras, the documents usually issued by the state-owned company follow standard models, and for this case the so-called instrument of awareness is used as the document in which Petrobras attests to being aware of the existence of financing, although it does not expressly consent to its early conditional assignment.

It is important to emphasize that, in a scenario of assignment of the main contracts, these should happen without any impact on the activities of the project.

10.4 Personal guarantees

The Project Finance structures may or may not count on corporate guarantees of the project shareholders. Projects that do not count on this type of guarantee are called *non-recourse* projects. On the other hand, those that have them may be *full recourse* or *limited recourse* projects, depending on the extent of this guarantee.

A common scenario is that in which the shareholders give a corporate guarantee in the construction phase of the project, in which the risk tends to be greater, so as to mainly guarantee the completion risk. In these cases, after the start of the product exploitation and commercialization, the corporate guarantee is removed so that the only guarantees to be kept are those related to the project. The end of the corporate guarantee may be conditioned to some events, such as meeting previously defined financial indexes, absence of additional costs, among other things.

It is also common that shareholders give guarantees in relation to the financing installment that will not be able to be paid during the period of the project, the so-called *balloon*. This happens when the project receivables, used according to the payment waterfall, are not enough to fully pay the resources provided by the lenders and, therefore, there is an excess debt by the end of the project, without there existing project coverage. In this case, depending on several factors, including the industry scenario, the lenders may request that the shareholders guarantee the excess.

10.5 Guarantee sharing

As the volume of resources needed for these transactions tends to be very high, it is common that the financing be granted by a syndicate of banks, which may be represented by an agent (either administrative or guarantee agent) or not. In any case, the guarantees must be shared among the syndicate members upon entering into an intercreditors' agreement. This document provides for how the guarantees will be shared (usually *pari passu*), the way by which the guarantees will be enforced, the quorum for making decisions related to the topics of interest by the syndicate, including approval of the guarantees' performance, among other subjects.

10.6 Conclusion

The world oil and gas industry operates with billions of dollars per year in structured financing transactions, representing a significant portion of all Project Finance made in the world every year.

The lenders, usually organized in syndicates, are granted a combination of personal guarantees and security interests in pure (non-recourse) or combined (full recourse or limited recourse) structured financings, making up for the project's guarantee package. As we sought to demonstrate here, these guarantee packages (naturally along with a quality project) are what enable the huge investments of this industry.

11. Application of article 93 of Law 8,213/1991 to offshore activities

Rodrigo Leite Moreira

Much is spoken about the application of article 93 of Law 8,213/1991 to offshore activity. There are varied violation notifications from the Ministry of Labor and Employment for non-compliance with the legislation on the grounds of disrespect for the minimum number of employees with disabilities.

The aforementioned article states that "a company with 100 (one hundred) or more employees is required to allocate between 2% (two percent) to 5% (five percent) of its job openings with rehabilitated beneficiaries or disabled persons, in the following proportion: (...)".

In this case, there is no specific and objective provision in relation to the calculation base of the quota mentioned in the said article, applying the calculation to all the activities of the company, even if, in such activities, the employment of persons with disabilities is not possible.

This, for example, is the case of companies involved in hazardous activities, which, for safety reasons, cannot employ people with disabilities.

This lack of legal provision leads the Ministry of Labor, the body responsible for overseeing compliance with the law, to issue infraction notices, charging high fines from companies and often culminating in the filing of a Public-Interest Civil Action by the Labor Prosecutors Office , indiscriminately and without due analysis of the company's activity.

For many companies engaged in oil exploration activities, meeting the quota of Persons with Disabilities (PCD) means having to employ on their onshore staff, that is, those who work in administrative duties, almost entirely, People with disabilities.

Notwithstanding the known difficulty of hiring people with disabilities, the intransigence in the understanding of the Ministry of Labor and Employment and the Labor Prosecutors Office leads to an unnecessary misunderstanding, such as the collection of very high fines, as well as numerous actions requiring the payment of compensation for non-pecuniary damages.

Obviously, as with apprentices, it would be reasonable if article 93 of Law 8,213/1991 could be *relaxed* for companies that have employees in offshore activities, so that they could exclude the respective job positions from their basis for calculation, since people with disabilities cannot work on boats.

Fortunately, the Labor Court has been adopting understandings that *relax* the application of article 93 of Law 8,213/1991, especially for oil companies. There are various decisions in this sense.

> "WORK ON AN OIL PLATFORM. QUOTAS. ARTICLE 93 OF LAW 8,213/91. ABSENCE OF COLLECTIVE NON-PECUNIARY DAMAGE. PRINCIPLE OF REASONABLENESS. The quota law, although it has not established exceptions, should be reasonably applied so that employers are not excessively punished for failing to meet the percentage of their total workforce. In the case of companies in the oil sector that engage in offshore work, the number of employees on board should be excluded from the quota calculation, since people with certain types of disabilities, for safety reasons, cannot work on oil platforms. According to the Professional Risk Theory, the employer must evaluate each case separately, certainly not avoiding the recommendation to consider the type of disability compared to the type of work offered, with the respective appropriate qualifications." (TRT-1 – RO 0148400-98.2009.5.01.0482 – Rapporteur Marcelo Antero de Carvalho. Date of Judgment: 11/23/2015. Tenth Panel. Publication Date: Dec/03/2015)

It is well-known that companies face many difficulties in hiring people with some type of disability, either due to lack of training of the professionals or even the lack of interest of workers who do not wish to lose welfare benefits. This difficulty in hiring people with disabilities gets worse when it comes to offshore work.

It is true that the quota law must be applied reasonably by work inspectors so that employers are not excessively punished for failing to meet the quotas set by law.

And when it comes to companies in the oil and gas sector that work offshore, the number of employees on board must be excluded from the quota base, since people with disabilities, for safety reasons, cannot work on oil platforms.

Therefore, it is extremely important for all companies, not only oil companies, to prove that they are trying to hire people with disabilities, given the great difficulty in hiring such workers. With this argument, the Labor Court has annulled various infraction notifications issued by the Ministry of Labor.

> "INTERLOCUTORY APPEAL ACTION FOR ANNULMENT. INFRACTION NOTICE. ADMINISTRATIVE FINE. QUOTAS FOR PEOPLE WITH SPECIAL NEEDS. NON-COMPLIANCE WITH ARTICLE 93 OF LAW 8,213/91. The Regional Court maintained the fine imposed upon the defendant, due to non-compliance with the provisions of article 93 of Law 8,213/91, stating that the plaintiff confines itself to indicating a conflict of regulations and is unable to satisfy the regulations for the protection of the physically handicapped, without, however, demonstrating, over the years, any concrete attempt to complete the quotas. It pointed out that there is no record of any actual study by the defendant corroborating the argument that it can not meet those quotas. The judgment under appeal emphasizes that the imposition of a percentage of people with disabilities who are qualified or rehabilitated results from is a combination of efforts aimed at inhibiting discrimination and full compliance with the principle of respect for human dignity. In this context, there is no indication of the alleged offense against the constitutional and legal provisions invoked in this appeal. Interlocutory appeal considered and not granted." (Case: AIRR - 134200-63.2007.5.02.0083 Date of Judgment: 07/Nov/2012, Rapporteur Justice: Dora Maria da Costa, 8th Panel, Publication Date: DEJT Nov/09/2012)

In the case of Oil companies, it is important that the quota law be complied with, but excluding from the basis of calculation the employees who work on oil platforms, activities acknowledged to involve risks, calculating only the onshore employees.

In case of an assessment by the Ministry of Labor and Employment or even the filing of a Public-Interest Civil Action, it is the responsibility of the company to demonstrate that it has taken all measures to hire Persons with Disabilities, even though only onshore employees are used as the basis of calculation.

12. Offshore environmental licensing

Carlos Maurício Maia Ribeiro
Pietro de Biase

12.1 Introduction

For decades the environmental agenda has increasingly gained the center of attention in public debate. Its origins go back to the emergence of international ecological awareness and to the first United Nations Conference on the Human Environment (Unche) (Stockholm, 1972), motivated to a large extent by the challenges of sustainability in development processes. In the international sphere, there has been a gradual enactment of norms protecting the environment.

Law nº 6,938 of August 31, 1981, which inaugurated the National Environment Policy (PNMA), established the National Environment Council (Conama), an entity responsible for determining standards and criteria for environmental licensing. Given the need to establish definitions, responsibilities, basic criteria and guidelines for the use and implementation of the environmental impact assessment, in January 1986, it released Conama Resolution nº 01, which submitted the environmental licensing of certain activities which might modify the environment to the previous preparation of an Environmental Impact Study and respective Environmental Impact Report (EIA/Rima).

In the wake of PNMA and inspired by the *Green* constitutions (Social Democratic State of Environmental Law) of Portugal (1976) and Spain (1978), Brazil established the protection of the natural environmental heritage as a constitutional norm by promulgating the Constitution of the Federative Republic of Brazil of 1988, which defines the rights and duties of the Government and the community in relation to the conservation of the environment as a common asset of all.

The relevance of the protection of the environment in the Brazilian scenario led the original constituent to receive the environmental impact assessment as

a condition for the implementation of works or activities potentially causing significant degradation of the environment.

12.2 Environmental licensing process

With the evolution of the environmental licensing experience before the environmental agencies, the need to review the procedures and criteria used in the licensing system became evident. In December 1997, Conama Resolution nº 237 was published, which regulated, in general standards, the competences for licensing at the federal, state and municipal levels, in addition to the stages of the licensing procedure, among other factors to be observed by the enterprises subject to environmental licensing.

In this sense, the administrative procedure for environmental licensing, if the project is approved, will culminate in the issuance of at least one environmental license, which, under Conama Resolution 237/1997, is characterized as an:

> "administrative act by which the competent environmental agency, establishes the conditions, restrictions and environmental control measures that must be obeyed by the entrepreneur, individual or legal entity, to locate, install, expand and operate enterprises or activities that use environmental resources considered as effective or potentially polluting or those that, in any form, may cause environmental degradation."

Resolution 237/1997 defines that environmental licenses may be of three types, namely: Preliminary License (LP), granted in the preliminary phase of planning the enterprise or activity, approving its location and design, certifying the environmental feasibility and establishing the basic requirements and conditions to be met in the next phases of its implementation; Installation License (LI) authorizing the installation of the undertaking or activity in accordance with the specifications contained in the approved plans, programs and projects, including environmental control measures and other constraints, of which they are a determining factor; Operating License (LO) authorizing the operation of the activity or undertaking, after verification of the effective compliance with what is stated in the previous licenses, with the environmental control measures and conditioning factors determined for the operation.

The environmental license may be granted alone or successively, depending on the nature and phase of the enterprise. The LP is valid for five years, while the LI cannot have a period of validity for more than six years. The terms of the LO vary between four and ten years.

Notwithstanding the regulatory advances made by the Brazilian environmental agencies since the creation of Conama, there were significant gaps in the licensing process that generated conflicts over licensing that usually ended up being resolved in court, due to the lack of clear regulation about jurisdiction.

12.3 Upstream environmental license

Thus, in 2011, Complementary Law 140 was enacted, which became the main nonconstitutional standard to discipline the federative competence for environmental licensing. The definition of the licensing body is based on the criterion of the extension of the environmental impact. In a brief summary, the municipal authority will be responsible for the licensing of activities and ventures whose impact does not exceed the territorial limits of the municipality (local impact). In the same way, activities whose impact is bound to the limits of the State will come under the jurisdiction of the state environmental agency. Finally, projects whose impacts exceed state, regional or national boundaries will be the responsibility of the Brazilian Institute for the Environment and Renewable Natural Resources (Ibama).

From another angle, it is worth noting that in addition to the criterion of the extension of the environmental impact, LC 140/2011 establishes the criterion of the dominance of the affected public good. In summary, when dealing with public assets (local, state or federal), the licensing authority will be the environmental agency linked to the political entity that holds the property. Thus, in local public assets, jurisdiction will, in principle, be the local environmental agency and so on.

It is worth mentioning that LC 140/2011 establishes that environmental licensing of exploration and production of oil, natural gas and other hydrocarbons located in deposits in the territorial sea, the continental shelf or the exclusive economic zone, will be the responsibility of Ibama, which, in turn will be guided by the directives established in Ordinance nº 422, of October 26, 2011 of the Ministry of Environment (MMA).

Ordinance MMA 422/2011 brought more objective criteria for the licensing of E&P activities. Among them, the delimitation of the drilling site, the rationalization of environmental studies, the Administrative Reference Process (PAR), a kind of information bank that aims to optimize the use of data in the licensing processes and finally the establishment of the single Licensing Process.

Currently the environmental licensing of the upstream is processed in the Coordination Office of Licensing of Marine and Coastal Enterprises (CGMAC) of Ibama, which in turn is subdivided into the Oil and Gas Exploration Licensing Coordination Office (Coexp) and in the Oil and Gas Production Coordination Office (Coprod).

It should be emphasized that Conama Resolution 23/1994 established two additional pre-licenses to LP, LI and LO, which are: Preliminary License for Drilling (LPper), which authorizes the drilling activity and the Previous License for Production for Research (LPpro), which authorizes the production to research the economic viability of the deposit.

12.4 Environmental studies

Among the environmental studies included in the environmental licensing of E&P activities that may be required of the entrepreneurs are the EAS-Environmental Seismic Study; the Environmental Drilling Study (EAP); Long-Term Testing Environmental Study (EATLD); the Environmental Control Plan for Seismic Surveys (PCAS), a document prepared by the enterprise in which the environmental control measures to be adopted in the seismic data survey should be reported to mitigate the environmental impacts, in addition to the EIA/Rima.

The EIA addresses the technical aspects necessary to evaluate the environmental impacts to be generated by the enterprise. The EIA must be prepared by a qualified multidisciplinary technical team, and should contain at least the environmental diagnosis of the area ofinfluence of the project, analysis of the environmental resources, their interactions, as they exist, to characterize the environmental situation of the area, before implementation of the project, considering the physical, biological and socio-economic environment.

The EIA should include an analysis of the environmental impacts of the project and its alternatives, by identifying, predicting the magnitude and interpretation of the

importance of the likely relevant impacts, indicating the positive and negative, direct and indirect, immediate and medium and long-term, temporary and permanent impacts, as well as their degree of reversibility, their cumulative and synergistic properties, and the distribution of social burdens and benefits. It should also define measures to mitigate the negative impacts, including control equipment and waste treatment systems, evaluating the efficiency of each of them. Finally, the EIA should provide for a program to follow and monitor the impacts of the activities.

The RIMA, in turn, will reflect the conclusions of the EIA and should be presented as clearly and objectively as possible in order to provide greater understanding to society about the characteristics of the enterprise, the environmental impacts associated with it, proposals for mitigating impacts, among other aspects of the implementation and operation of the enterprise. The information must be translated into accessible language, illustrated by maps, charts, pictures, graphs and other visual communication techniques, so that the advantages and disadvantages of the project can be understood as well as all the environmental consequences of its implementation.

It is worth mentioning that for the concession of the LPper, the entrepreneur should present the Environmental Control Report (RCA), which must include a description of the drilling activity, the environmental risks involved, the identification of impacts and mitigating measures. As for the expedition of the LPpro, it is necessary to present the Environmental Viability Study (EVA), prepared by the entrepreneur, containing a production development plan for the intended research, with an environmental assessment and indication of the control measures to be adopted.

The Environmental Drilling Survey (EAP) must present an assessment of the non-significant environmental impacts of marine drilling activity on marine and coastal ecosystems.

The Environmental Seismic Survey (EAS) consists of the document prepared by the entrepreneur that presents the assessment of the non-significant environmental impacts of marine seismic research activity in marine and coastal ecosystems.

To carry out the well tests, carried out during the exploration phase, with the main purpose of obtaining data and information for the knowledge of the reservoirs, with a total flow time exceeding 72 hours commonly called Long Duration Tests (TLDs), it is necessary to present the Environmental Long-Term Testing Study (EATLD) which presents the evaluation of the non-significant environmental impacts of the long-term test activity on marine and coastal ecosystems

Finally, the entrepreneur should present an Environmental Control Plan for Seismic Surveys (PCAS) that will provide the environmental control measures to be adopted during the seismic data survey, as well as information on vessels and equipment used.

Another innovation brought by MMA Ordinance 422/2011 was the provision of the Environmental Assessment of Sedimentary Area (AAAS) in order to diagnose the socio-environmental impact of E&P activities and enterprise, generating subsidies for the classification of the aptitude of the area evaluated for development of these activities and the definition of recommendations to be integrated into the decision-making processes related to the concession of exploratory blocks and their environmental licensing.[1]

12.5 Environmental compensation

To counterbalance the negative socio-environmental impacts identified in the licensing process, Federal Law nº 9,985, of July 18, 2000, which established the National System of Nature Conservation Units (SNUC), stipulates that in cases of environmental licensing of enterprises of significant environmental impact, such as oil and natural gas E&P, based on the EIA/Rima, the entrepreneur will be obliged to support the implementation and maintenance of the Conservation Unit (UC) of the Integral Protection Group and, if directly affected, also those of the Sustainable Use Group.

Decree nº 4,340 of August 22, 2002, regulated the application of environmental compensation. According to the abovementioned law, the formula for calculating the environmental compensation will take into account the total costs expected for the implementation of the project (Reference Value). Currently, the compensation is calculated by the product of the reference value by the Degree of Impact on biodiversity, commitment of protection areas and in conservation units, this in turn, established by the environmental authority from EIA/Rima, as provided for by Conama Resolution 371/2006.

Investments related to the plans, projects and programs required in the environmental licensing procedure for mitigation of impacts are not included in the calculation of the environmental compensation.

1 See article on Strategic Environmental Assessment in the supply of E&P blocks presented during Rio Oil & Gas 2018 and published in this work.

It should be noted that in a recent[2] ruling, the Federal Court of Accounts (TCU) dismissed the appeal filed by the Chico Mendes Institute for Biodiversity Conservation (ICMBio) and MMA and determined that compliance with environmental compensation should be carried out in the direct mode, execution of services and implementation of programs in the PAs, to the detriment of the indirect mode that took place by payment in cash in a book entry account. Pursuant to Law nº 13,668 of May 28, 2018, ICMBio was authorized to select an official financial institution to create and manage a private fund to be paid with resources from environmental compensation.

12.6 Decommissioning

Among the objectives of the National Environmental Policy is the imposition on the polluter of the obligation to recover damages caused to environmental resources by their use for economic purposes. In addition, the PNMA establishes the duty to restore environmental resources with a view to their rational use and permanent availability.

Substantially, decommissioning can be defined as a set of legal actions, techniques and engineering procedures applied in an integrated way to an enterprise or part of it, to ensure that its decommissioning or withdrawal from operation meets the safety conditions, preservation of the environment, reliability and traceability of information and documents. The obligation of decommissioning is embodied in the Environmental Principle of Integral Reparation, since it falls to the environmental civil responsibility of the entrepreneur, which obliges him to reestablish the *status quo ante* of the natural environment.

Since it is an obligation of compliance only at the end of the productive period, it is not at times a primary concern of the concessionaires when the contracts are signed. As field reserves come to an end, there is a need for decommissioning facilities. In this regard, the ANP[3] is currently seeking to revise Resolution nº 27/2006 on procedures to be adopted in decommissioning facilities and the conditions for the return of concession areas in the production phase.

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2 Judgment 1,004/2016 – Federal Court of Accounts.

3 Available at: <http://www.anp.gov.br/exploracao-e-producao-de-oleo-e-gas/seguranca-operacional-e-meio-ambiente/projeto-oil-gas-decommissioning-from-the-uk-s-north-sea-to-the-brazilian-atlantic> Accessed on: August 04, 2018.

All in all, there is no specific environmental regulation to establish the minimum environmental requirements to be observed when decommissioning E&P facilities. However, it should be pointed out that Ibama[4] Normative Instruction nº 22 of July 10, 2009 authorizes the transformation of vessels and offshore platforms into artificial reefs according to a Decommissioning Logistics Plan that should cover the treatment given to adapt it for the proposed purpose, with the removal of sharp corners and the total removal of potentially polluting substances and materials

Indeed, the issue lacks consensus and is on the agenda of the day. This is because the blocks of Round Zero, which Petrobras obtained the ratification of its rights, are close to the end of production leading to the need for decommissioning of certain offshore facilities, due to the end of the productive life of some wells.

The emergence of clearer regulation on decommissioning is intensifying since among the assets that were included in the Petrobras Divestment Plan are several mature fields whose decommissioning will be the responsibility of the purchasers.

12.7 New legislation – PL 3,729/2004

Draft Law nº 3729/2004 (PL 3729/2004), currently under analysis in the Chamber of Deputies[5], proposes to revisit some sensitive points to the environmental licensing provided by LC 140/2011. The aforementioned PL sought to incorporate suggestions brought by sectors of society in identifying the main bottlenecks of the environmental licensing process in Brazil.

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4 "Art. 10. The establishment of artificial reefs in places that threaten the integrity of reef formations and other habitats protected by specific legislation in their area of direct influence is prohibited.
§ 1. The establishment of artificial reefs in estuaries, lagoons and inland waters is prohibited, except when defined in terms of fisheries management by means of specific regulations or for the purpose of scientific research.
§ 2. The installation of artificial reefs in calcareous algae bottoms is subject to the viability analysis by the competent body.
§ 3. In the case of vessels and offshore platforms, a decommissioning logistics plan should be submitted to Ibama, covering all treatment given to adapt them to the proposed purpose, with the removal of sharp corners and the total removal of potentially polluting substances and materials (oils and fuels, asbestos, PCBs, antifouling paints, materials that can float and pose risks, plastics, glass, batteries, antifreeze, mercury lamps, etc.) in compliance with the Maritime Authority Standards for Naval Inspection Activity."

5 Available at: <http://www.camara.gov.br/proposicoesWeb/prop_mostrarintegra?codteor=1592274&filename=SBT+11+CFT+%3D%3E+PL+3729/2004> Accessed on: August 06, 2018.

It is worth noting that PL 3729/2004 offers the possibility of licensing agencies offering to entrepreneurs who adopt more efficient technologies of environmental control special licensing conditions, such as a reduction of the periods of analysis, extension of the periods for renewal of licenses, simplification of the licensing procedure, etc.

In turn, expiration dates were established for each type of environmental license, reinforcing the provision already provided in LC 140/2011 of a single supplementary application in the course of the licensing process.

In addition, it was envisaged that activities or undertakings with totally or partially overlapping areas of influence may, at the discretion of the licensing authority, have the environmental conditions implemented in an integrated manner, provided that the responsibilities for compliance are defined. The established conditions cannot oblige the entrepreneur to operate public services.

Lastly, PL 3,729/2004 enshrines the Strategic Environmental Assessment (SEA) as an environmental policy instrument capable of evaluating, previously and strategically, broader government policies, plans and programs, seeking to prevent any possible issues from being discussed in the scope of the licensing activities.

12.8 Conclusion

The challenge of sustainable development has multiple agendas, involving government, business and civil society. The 1987 Brundtland Report (Our Common Future), developed by the World Commission on Environment and Development, emphasized sustainable development as capable of "meeting present needs, without compromising the ability of future generations to meet their own needs".

As from the reforms carried out in the 1990s, the Brazilian State underwent a process of modernization the effects of which are reflected in a greater dynamism of the economy and a re-dimensioning of the processes of development. The dynamics of investments in infrastructure combined with the need for energy security, among other things, led to a marked increase in applications for environmental licensing.

In the environmental sector, the process of modernization of the Brazilian State brought the perspective of the approach of the environmental variable as a constraint to the development process. This scenario is peculiarly symptomatic

in that the licensing process is sometimes associated with a *hindrance* to the development of the country, either because of its high cost or because of the time it takes to issue licenses.

In this regard, the dynamism of licensing is a major challenge for the legislator, which is to ensure energy security and national development in a sustainable way, materializing the ecological commitments signed by Brazil before the international community.

13. Ballast water disposal: Discipline through state norms

Carlos da Costa e Silva Filho

13.1 Introduction

Up to the end of the 19th century, the volume of long-distance sea voyages was relatively modest, compared to that which occurs today, and also, the control of the vessels' balance was achieved by means of solid ballast[1], especially through the use of sand or rocks.

However, the exponential increase in sea voyages, driven by the use of sources generating kinetic power more efficient than those existing until then (wind and coal), and more recently, the insertion of the vast majority of the countries in a worldwide commercial exchanges system depending, on a large scale, on the maritime transportation system, brought with it, on the one side, the change in the way of ballasting the vessels and, on the other side, environmental risks until then not detected.

Effectively, with the shortage and operational difficulty in adding and removing solid ballast material at the ports, water started being used as ballast for vessels,[2] water which included living organisms, even if in a planktonic phase. With that, and also as a result that living organisms that fix themselves to the hulls of ships (biofouling) are displaced from one ocean to the other across

1 FONSECA, Maurílio Magalhães. *Arte naval*. 7th ed. Rio de Janeiro: Navy Documentation Service, 2005. v. 1 *apud* SOUSA, Marcos Ticiano Alves de. *Bioinvasão provocada pela água de lastro de embarcações: Consequências jurídicas* (Bioinvasion caused by ballast water in vessels: Legal consequences). Jus Navigandi Magazine, Teresina, year 20, nº 4,466, Sept 23, 2015. Available at: <https://jus.com.br/artigos/42998> Accessed on: Feb 4, 2017.

2 According to the definition included in Normam 20/2005 (Norm of the Maritime Authority for the Management of Ballast Water of Ships), ballast water is "water with its particles in suspension taken aboard a vessel in its ballast tanks, in order to control the trim, draft, stability or tensions of the vessel".

the globe, the invasion of habitats by non-autochthonous species (bioinvasion) started being perceived, as well as the gradual the loss of local biodiversity.

It is, therefore, a phenomenon typical to *risk societies*[3], *in which the typical modus operandi* of (post) industrial modernity and the risks created by it are in conflict, with such risks, in the classic modernity, being deemed residual and insignificant, when compared to the costs of non-progress.[4]

In order to deal with this unbalance that the technical overcapacity caused on the forces of nature[5], a series of normative measures are being adopted, both in that which concerns international law and that which relates to domestic law.

This article has, therefore, the purpose of identifying the norms adopted by the federal legal system to control bioinvasion through disposal of ballast water, and verifying whether there is room for the legislating work of the member States in light of the partition of competences set forth by the current Constitution of the Republic.

13.2 Environmental pollution by ballast water: Normative treatment

As briefly referred to before, the invasion of the maritime habitat by exotic species – whether by means of dumping of ballast water, or through biofouling –, with the consequent loss of aquatic biodiversity, is a problem on which attentions have only recently focused, if compared to the millennial aspect of maritime transportation.

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3 See BECK, Ulrich. *La sociedad del riesgo. Hacia una nueva modernidad*. Barcelona: Ediciones Paidos Ibérica, 1998.

4 In the words of Beck *et alii*, "it may be virtually said that the constellations of the risk society are produced because the certainties of the industrial society (the consensus towards progress or the abstraction of the effects and ecological risks) dominate the thoughts and actions of the persons and institutions in the industrial society. The risk society is not an option that may be chosen or rejected throughout the course of political disputes. It arises from the continuity of the autonomous modernization processes, which are blind and deaf to their own effects and threats. In a cumulative and latent manner, these latter produce threats that question and ultimately destroy the bases of the industrial society". (BECK, Ulrich; GIDDENS, Anthony; LASH, Scott. *Modernização reflexiva: Política, tradição e estética na ordem social moderna.* 2nd reprint. São Paulo: Unesp Publisher, 1997, p. 16).

5 See SOARES, Cláudia Alexandra Dias. Stvdia ivridica 58 – O imposto ecológico. Contributo para o estudo dos instrumentos econômicos de defesa do ambiente. Coimbra: Coimbra Publisher, 2001, p. 34.

With the exponential development of sea voyages, mainly motivated by the intensification of international trade, and with the harmful potential on the environment resulting from unrestricted dumping of ballast water – such potential being materialized in cases such as the European zebra mussel *Dreissena polymorpha*, which infested 40% of the waterways in the United States[6], and the American comb jelly *Mnemiopsis leidyi*, which depleted the native plankton stocks contributing toward the collapse of all commercial fishing in the Black Sea[7] –, the increasing international concern regarding the issue has taken shape, initially by means of the International United Nations Convention on the Law of the Sea from 1982 (Montego Bay Convention), articles 194, 207 to 212 and 235, which prohibit cross-border pollution and establish the obligation for each country to adopt the national and international legislation to prevent, reduce and control pollution in the maritime environment.

Next, the International Maritime Organization (IMO), along with its Maritime Environment Protection Committee (MEPC), established a work group to deal with the issue, such effort resulting in the publication of MPEC Resolution nº 50 (31), of 1991, of a volunteer nature, accepted by the IMO Meeting through Resolution A nº 774 (18), of 1993, and succeeded by Resolution A nº 868 (20), of 1997, with the "Guidelines for the Control and Management of Ballast Water from Ships, to Minimize the Transfer of Harmful Aquatic Organisms and Pathogenic Agents".

Finally, on February 16, 2004, following the trail blazed by the Montego Bay Convention[8], the International Convention on the Control and Management of Ballast Water and Sediments from Ships, of 2004 (Ballast Water Convention) came into existence, this convention, under the terms of its article 18, upon the

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6 CAMACHO, Wellington Nogueira. *Aspectos jurídicos acerca da poluição causada por água de lastro*. Environmental Law Magazine, São Paulo, year 12, n. 46, p. 191-222, Apr./Jun. 2007.

7 Available at: <http://www.mma.gov.br/biodiversidade/agua-de-lastro/contexto>

8 According to the lesson by Maria Helena Fonseca de Souza Rolim, "the Ballast Water Convention refers to fundamental principles regarding the protection of the maritime environment, particularly those adopted by CONVEMAR [Montego Bay Convention] and CDB [Convention on Biological Diversity], with emphasis on the principles of prevention, precaution, international cooperation, transfer of technology and prohibition of cross-border pollution". (ROLIM, Maria Helena Fonseca de Souza. *A Convemar e a proteção do meio ambiente marinho: Impacto na evolução e codificação do direito do mar – As ações implementadas pelo Brasil e seus reflexos no direito nacional*. *In:* BEIRÃO, André Panno; PEREIRA, Antônio Celso Alves (org). *Reflexões sobre a Convenção do Direito do Mar*. Brasília: Alexandre Gusmão Foundation, 2014, p. 356).

adhesion of Finland to its terms, having come into effect on September 08 of the current year.

The Ballast Water Convention typifies the rights and obligations of the Flag State, Port State and Coastal State in the main body, covering 22 articles, whereas its Annex presents the technical aspects related to the control and management of ballast water from ships and the sediments therein included, deserving of attention the rule according to which the changes of ballast water must occur at a distance of at least 200 nautical miles, when possible, or without failure 50 miles away from the coast and at least 200 meters deep, as the salinity, which is higher in the high seas, reduces the chances of survival of organisms from coastal and fluvial environments.[9]

In Brazil, still under the aegis of the previous Constitution, the issue concerning maritime pollution caused by vessels - although not specifically resulting from the dumping of ballast water – was subject to Law nº 5,357/67, which attributed the inspection of its provisions to the Directorate of Ports and Coasts of the Ministry of the Navy, even though in cooperation with other interested federal and state bodies.

At the time of the advent of the National Environment Policy Law (Law nº 6,938/1981), its article 14, § 4 determined that "in cases of pollution caused by the spillage or release of debris or oil in Brazilian waters, by maritime or fluvial vessels and terminals, the provisions of Law nº 5,357, of November 17, 1967, shall prevail", therefore reaffirming the effectiveness of the provisions of the previous Law.

In 1987, the Montego Bay Convention, previously referred to herein, received legislative approval through legislative Decree nº 05/1987, but its enactment only took place when the new constitutional order came into effect, through Decree nº 1,530/1995, when Law nº 8,617/1993 was already in force, enacted in accordance with the Montego Bay Convention, recognizing Brazilian jurisdiction up to the external limit of the exclusive economic zone, with the "exclusive right to regulate maritime environment protection and preservation" (according to art. 8, Law 8,617/1993).

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9 According to Tiago Vinícius Zanella, "due to the large volume of water that is dumped into the estuaries by the rivers that debouch into the sea, the salinity near the coastline is lower than in the high seas. The embryos of species that live beyond the 200 mile limit do not survive when introduced in waters with lower salinity, such as port bays". (ZANELLA, Tiago Vinícius. *Água de lastro: Um problema ambiental global*. Curitiba: Juruá, 2010, p. 78)

Around four (4) years later, Law nº 9,537/1997 (Safety of Waterway Traffic Law – Lesta) was enacted, of which articles 3, head provision, and 4, VII, granted competence to the maritime authority to adopt measures to prevent and control environmental pollution coming from vessels.

The powers/duty conferred upon the maritime authority to adopt executive measures to prevent environmental pollution originating from vessels, as well as to establish requirements, through lower normative acts, to prevent said pollution, was reinforced by the provisions of articles 16-A and 17 of Complementary Law nº 97/1999 (and, later, by article 70 of Law nº 9,605/1998), which recognized, among other things, the agents of the Port Authorities and of the Ministry of the Navy as competent authorities to issue notices of environmental violation and to institute administrative procedures.

Finally, on April 2000, Law nº 9,966/2000 was enacted, which provides for the prevention, control and inspection of the pollution caused by the release of oil and other harmful or dangerous substances in waters under national jurisdiction. Apart from exceptions provided by the same law, it established the generic prohibition of the discharge in waters under national jurisdiction, of ballast water, among other harmful or dangerous substances, and, since article 14, § 4, of Law nº 6,938/1981 had been revoked, its article 27 attributed the competence for the enforcement of the law upon federal, state and municipal authorities, with the sole paragraph of article 29 remitting to the previous regulation the definition on how the environmental and maritime authorities would act in coordination.

The regulation of the law, set forth by Decree nº 4,136/2002, followed the general criterion according to which whenever pollution resulted from vessels, the competence for the inspection and imposition of sanctions would be that of the maritime authority, whereas whenever the pollution originated in ports, marinas, shipyards, sailing clubs or coastal facilities, the competence would be that of the relevant environmental bodies.

Thus, articles 19 to 27 of the aforementioned Decree, which concern the violations resulting from the transportation of harmful substances *by ships* (Subsections IV and V of Section II of Chapter II of the Decree), the inspection body would be the *maritime authority* (according to art. 28), which can also be verified as relation to the provisions of articles 29 and 32, which explicitly refer to the discharge of ballast water by vessels.

In their turn, articles 31 and 33 of the same Decree attribute the competence for administrative sanctioning to the environmental bodies, and not to the maritime authority, when the discharge of harmful or pollutant substances, among them being ballast water, comes from organized ports, port facilities and ducts, that is, from fixed structures.

With the execution of the International Convention on the Control and Management of Ballast Water and Sediments from Ships, on February 13, 2004, and with the purpose of giving effect to the provisions included in article 52 of Decree nº 4,136/2002, Normam 20/2005 (Norm of the Maritime Authority for the Management of Ballast Water from Ships) was issued.

Finally, with the publication of legislative Decree nº 148/2010 and the deposit of the respective ratification instrument with the International Maritime Organization (IMO), and with the entry into force of the Ballast Water Convention on September 08 of the current year (2017), by force of the provisions of its article 18, Brazil had one more law making provisions on the matter, considering that treaties, in general, have the strength of an ordinary law.[10]

This is the existing legislative framework, within the scope of the Union, to deal with pollution caused by undue disposal of ballast water, with a very comprehensive nature. Could the member States, even so, also set forth norms on this topic?

The doubt is relevant because several Brazilian States are located on the coast and have public ports and private port terminals along their coastlines, and also because, recently, in a movement that may stimulate the state legislative production on the topic, the Federal Supreme Court denied Direct Action for the Declaration of Unconstitutionality nº 2,030, which questioned the constitutionality of provisions of Law nº 11,078/1999 of the state of Santa Catarina, which set forth norms on the control of waste from vessels, oil pipelines and coastal facilities.

10 It is worth remembering that the referred to Convention provides on environmental pollution resulting from the dumping of ballast water, and, with the understanding that the right to a well-balanced environment is one of the fundamental human rights, it will be tenable to attribute to the Convention, after its internalization is complete, the power of a constitutional amendment, if § 3 of article 5 of the Constitution is respected, or, if the constitutional quorum is not reached, a hierarchy higher than that of a merely ordinary law, according to RE 349.703/RS.

The examination of the decision rendered by the Supreme Court will be carried out next, not without first revisiting the topic on the partition of competences among federative entities.

13.3 Partition of competences: Criterion of the prevailing interest

The presentation, carried out in the previous chapter, of the normative framework within the scope of international law and within the domestic scope, in relation to the protection of the aquatic environment against pollution resulting from the inadequate disposal of ballast water, demonstrates that the Federal Union has repeatedly legislated on the topic, and it does so for basically two reasons: (i) ballast water is an issue pertaining to the law of the sea, as it refers to the use of water as a means to provide stability on the vessels, its use being a common procedure adopted in the whole world, long before the environmental damages resulting from its undue disposal could be perceived, and the competence to legislate on the law of the sea is incumbent upon the Union; and (ii) the environmental pollution related to the release of ballast water into the maritime environment may be considered a type of cross-border pollution, which claims from the country measures to protect its aquatic fauna in the exercise of its sovereignty.

The Constitution of the Republic, in its article 22, item I, establishes that it is privately incumbent upon the Federal Union to legislate on the law of the sea, as well as item X of the same provision establishes that the Union is responsible for legislating on lacustrine, fluvial and maritime navigation, considering that the member States may only legislate on such matters if they are duly authorized by a complementary law (according to art. 22, sole paragraph, CRFB/1988), currently nonexistent. It is an option of the constitutional legislator to obey the logic, as the law of the sea and navigation are topics that, ultimately, concern the relationship between Brazil and foreign countries, their citizens and companies, it being certain that the most significant part of international trade is transported by sea.

It could be assumed that, by force of what is included in items VI to VIII of article 24 of the Constitution, there would be room for the exercise of legislating activity by the member States in relation to the topic which is the subject to this

analysis. It happens that the legislating competence of the member States, under the terms of §§ 3 and 4 of article 24 of the Constitution, may be fully exercised in case there is no federal law concerning the topic, and, as seen, the federal legislative production regarding the matter is extensive, making any supplementation by the other federation entities unnecessary, unless otherwise stated.

It might be added that the supplementary competence of the member States, provided by §§ 1 to 4 of article 24 of the Federal Constitution (as well as the competence of the Municipalities, resulting from article 30, I and II of the Constitution), may only be exercised to deal with matters of their *particular interest*, as § 3 of article 24 refers to state legislation to meet peculiarities of each State.

Truly, the criterion adopted by the legislator to list the private legislative competences of the Union, which also serves to clarify problems pertaining to the concurrent legislative competence, is that of prevailing interests, so that, in case the federal interest prevails and the need to regulate a given matter is exhausted, there is no room for legislative filing by the other federative entities (according, for all, to the Federal Supreme Court, Full, ADI 3,035/PR, Judge Rapporteur Gilmar Mendes, Court Register of October 14, 2005).

In short, if it is certain that, under the terms of the Federal Constitution, it is concurrently incumbent on the Union and the member States to legislate on forests, hunting, fishing, fauna, nature conservation, soils and natural resources defense, environmental protection and pollution control (CRFB/1988, article 24, item VI), it is also certain that the competence of the state entities is limited to supplementing a federal norm, *whenever there is room for such*.

In the case already mentioned, concerning ADI 2,030, the contents of Law nº 11,078, of January 11, 1999, of the State of Santa Catarina, were under discussion, as it intended to set forth procedures and criteria to control wastes originated from vessels, oil pipelines and coastal installations. One of the challenged articles (art. 4) provides that "vessels shall have adequate systems to receive, select and dispose of their own wastes, which shall be discarded only in onshore facilities".

The trial occurred on August 09, 2017 and there was no publication of the respective appellate decision up to the present date (August 30, 2018). News obtained from the webpage of the Federal Supreme Court informs that the appellate judges had understood that the questioned norms did not regard the matter of the law of the sea, which is specific to the Union, but the matter of environmental law, therefore considering the exercise of concurrent legislative competence on the part of Santa Catarina as lawful.

The same news extracted from the webpage of the Federal Supreme Court, however, comments that, according to the vote of the Judge Rapporteur, since at the time the challenged legislation was published there was no general law on the topic, the member States had full legislative competence on that matter and might supplement the normative space with local legislation, but that, "with the prevailing nature of a law on the matter, the legislation of Santa Catarina might lose its normative strength in that which it would contradict the general ruling legislation".

Now, ballast water has been a topic subject to federal legislative treatment for a long time, so that, as to its kind, there would be an inconsistency in the decision, as the law of Santa Catarina includes in the concept of waste what it also calls *dirty ballast* (art. 2, head provision). And, even if there were no law at the time of the trial, the decision therein rendered would have to be reexamined in light of the entry into force of the Ballast Water Convention on September 08, 2017.

It should be considered that one of the constant claims of the initial pleading was that the law of Santa Catarina would be contrary to the Convention on the Prevention of Maritime Pollution due to Dumping of Waste and other matters. These grounds did not come to be analyzed, as they exceeded the limits of the direct action for the declaration of unconstitutionality (the convention would not be a parameter to control constitutionality). The case of ballast water, however, is not about contrasting a state law and an international convention, but rather a state law and a federal law (as the treaty would have been accepted by the legal system of the country either as an ordinary law or as a constitutional amendment).

Thus, with the necessary reservations as to the fact that there is no appellate decision published that is subject to a detailed analysis, and without examining the cases related to the other types of waste subject to the law of Santa Catarina, it can be considered that the decision rendered by the Federal Supreme Court in the case in question deserved to be cleared of its defects in a motion for clarification.

Could then the member States, not through laws, but by means of normative administrative acts, regulate the matter pertaining to the disposal of ballast water? It is a material possibility, as the opinion of jurists

admits the production of normative acts by the Administration, as an exteriorization of its police power.[11]

To answer this question, it is worth remembering that, as regards administrative competence, article 23 of the Constitution establishes that the Union, States, Federal District and Municipalities are responsible for protecting the environment and fighting pollution in any of its forms (item VI) and preserving the forests, fauna and flora (item VII).

Despite it being a common competence of all federative entities, the opinion of jurists and court precedents have always understood that, in light of a given material case, one and only one of the entities would have the specific attribution to act, and that the criterion to limit the definition of the competent entity would be, once again, that of the prevailing interest.

The positioning of the Federal Supreme Court, extracted from Internal Interlocutory Appeal in the Provisional Remedy of the Action for a Provisional Remedy nº 1255/RR, drafted by Appellate Judge Celso de Mello, reasons this way, in which said Judge clarifies that:

> "considering the constitutional partition of competences on the environmental matter, that, in the event there is a conflict between political entities on the performance of attributions common to them – as would occur, for example, in the exercise of the material competence referred to in items VI and VII of art. 23 of the Constitution -, such conflicting situation must be resolved by application of the criterion of the prevailing interest and, whenever possible, by the use of the criterion of cooperation between the entities making up the Federation."

Now, understanding that cross-border pollution is that resulting from the undue dumping of ballast water by vessels, the prevailing interest in

11 See SUNDFELD, Carlos Ari. *Direito administrativo para céticos*. 2nd ed. São Paulo: Malheiros; CASTRO, Sonia Rabello de. *O poder de polícia normativo, o direito urbanístico e as normas de planejamento urbano.* Thesis prepared as a Partial Requirement for the Competitive Examination for the position of Full Administrative Law Professor of the Law School of the State University of Rio de Janeiro. Rio de Janeiro. Nov-2001. From the work of the abovementioned jurist, the following excerpt may be extracted: "Today, it is very common that the public administration use the administrative normativity in several of its areas of activity and, especially, in the areas of intervention in the economic domain; the administrative practice has been using this type of normativity in an increasingly intense way, to the extent that the object of the ruling is more complex, more technical and, at the same time, more dynamic".

relation to the adoption of prevention, control and inspection measures is that of the Federal Union.

Anyway, specifically in relation to the common competence related to environmental protection, and in the exercise of the option provided by the sole paragraph of article 23 of the Constitution of the Republic, Complementary Law nº 140/2011 was published on December 08, 2011, which establishes norms for cooperation between the Union, States, Federal District and Municipalities.

First of all, it should be mentioned that article 3, item IV of the above-mentioned Complementary Law establishes that one of the fundamental purposes of the Union, States, Federal District and Municipalities is to "guarantee the consistency of the environmental policy for the whole Country, respecting the regional and local peculiarities", which, in other terms, means that the existence of regional and local peculiarities is that which justifies the state and municipal actions.

Observing the already mentioned criterion of prevailing interest, Complementary Law nº 140/2011, in its article 7, item XVII, defined as an attribution of the Federal Union the control of the introduction into the Country of exotic species that might threaten the native ecosystems, habitat and species.

More than that, item XXIV of the same article 7 establishes that it is the competence of the Union to exercise environmental control on the maritime transportation of dangerous products, it being important to remember, by the way, that the treatment given by Law nº 9,966/2000 to ballast water is similar to that given to oil, both being therefore inserted into the concept of *dangerous products.*

Now, if the Union was granted competence for such administrative actions, it may, and not the other federative entities, publish the normative acts needed to implement such measures, according to the provisions in the logic inherent to the Theory of Implied Powers.

Thus, Complementary Law nº 140/2011, in relation to the topic herein examined, later ratified everything that had been regulated by the legislation on the law of the sea and the environmental legislation produced until then, placing, once again, in the hands of the Federal Union, the exercise of the environmental police power in relation to the ballast water released by vessels, so that, also from the material, administrative competence point of view, there is no room for requirements made by means of state normative administrative acts.

13.4 Conclusion

In view of the foregoing, even if we accept the thesis that the disposal of ballast water is a matter that, due to its repercussion and environmental relevance, does not fit into the specific competence of the Union to legislate on the law of the sea – as the Federal Supreme Court understood in ADI 2,030 –, even so, except for some regional peculiarity, duly assessable, that justifies the state legislating intervention, the Union is responsible for the competence to publish legal and administrative norms dealing with the topic.

14. Strategic environmental assessment in the process of offering blocks for petroleum and natural gas E&P in Brazil

Pietro De Biase

14.1 Introduction

Art. 2 of Law 9,478 of August 6, 1997, the Petroleum Law, authorizes the National Council for Energy Policy (CNPE) to define which blocks will be offered for concession or production sharing agreements. The same law instituted the National Agency of Petroleum, Natural Gas and Biofuels (ANP), which is responsible for the promotion of the auctions for the concession[1] of exploratory blocks and for enforcing good practices of conservation and the rational use of the petroleum, natural gas and preservation of the environment, to better comply with the guidelines of the CNPE. Based on these guidelines, the ANP prepares the rounds of bidding for E&P blocks.

Prior to the rounds, the ANP performs the sectorial planning of the expansion of the E&P activities, and the CNPE approves the areas and the dates of the auctions. In brief, the planning stage includes the proposal of areas to be offered and the determination of the technical and legal qualification criteria. The delimitation of the blocks put up for offer is based on two determining factors, namely: the availability of geological and geophysical data that demonstrate indications of the presence of oil and natural gas and the preliminary appraisal of the environmental conditions (ANP, 2007).

1 Law 12,351 of December 22, 2010 instituted the production sharing system in areas of the pre-salt and in strategic areas. In this system, the contracts are executed on behalf of the Federal Government by the Ministry of Mines and Energy.

Despite the analysis of the environmental conditions, the inclusion of the environmental vector in the sectoral planning in the offer of blocks by the ANP is still proving to be insufficient for harmonizing E&P activities with those of caring for the environment, as determined by the Petroleum Law. This is because the process of achieving the objectives of the petroleum and natural gas policies and those of the environmental agenda, both of national interest, have proven to be, up to the present time, condensed substantially into the process of environmental licensing, which is full of doubts and uncertainties both for the regulatory agency as well as for the concessionaires.

The publishing of CNPE Resolution nº 8/2003 introduced the formal integration of the environmental variable as one of the requirements for the planning and selection of the blocks. This Resolution also established that the choice of the areas to be put up for auction, should be preceded by a joint manifestation of the ANP, the Brazilian Institute of the Environment and Renewable Natural Resources (Ibama)[2] and of the environmental agencies of the States, when applicable, and the possible exclusion of areas due to environmental restrictions, This institutional dialogue laid the foundation for the strengthening of the sectorial planning prior to the formal decision-making about which blocks should be offered.

The Ministry of the Environment (MMA), through Regulation 218/2012, instituted the Inter-institutional Working Group and Oil and Gas Exploration and Production Activities (GTPEG), the objective of which was to technically support the dialogue with the oil and natural gas exploration and production sector, specifically with regard to the environmental appraisals prior to the definition of areas for authorization and the strategic recommendations for the process of environmental licensing of these activities in the national territory. The GTPEG is composed of members of the MMA, Ibama, the Chico Mendes

2 It should be remembered that since 1999, the MMA, Ibama and the ANP have laid the foundations for the institutional dialogue to define a working agenda that made it possible to implement the necessary measures for the review of the environmental licensing system, the improvement of other environmental management instruments and the preparation of environmental sensitivity charts, to improve the addressing of the environmental variable in the E&P process. The objective was to reduce the uncertainty regarding the environmental variable of the oil production activities. This process resulted in two specific instruments: the first, of a political/institutional nature, the Petroleum Environmental Agenda, executed in the year 2000 by the MMA and ANP; and the second, the Environmental Licensing Guide, launched in 2002, in its first version (MMA, 2002).

Institute for the Conservation of Biodiversity (ICMBio) and National Waters Agency (ANA).

Currently, due to Resolution nº 17/2017, the environmental variable is incorporated into the planning for the offer of exploratory blocks, by means of the prior analysis of the regulatory environmental bodies with the objective of excluding areas for environmental restrictions because of the overlapping of conservation units or other sensitive areas where E&P activities are not possible or recommended. The result of this analysis is based on the Preliminary Technical Opinion of the GTPEG which, in turn, will be included in the Environmental Licensing Guide[3], allowing the future concessionaire to include the environmental variable in its technical and economic feasibility studies of the projects.

The end of the practice of the monopoly by the Petroleum Law generated an increase in the demand for environmental licensing, but due to the lack of clarity in the environmental conditions, it resulted in an explosion of costs for the E&P segment. According to Costamilan, the environmental licensing process of the operational cycle is at times greater than eighteen months, while the exploratory phase lasts on average, for three months, that is, 20% of the time of this cycle, the remainder referring to the licensing process. In general, it is estimated that in infrastructure projects with an extensive life cycle, as is the case in E&P activities, the licensing process involves, on average, 8% on the time cycle of the enterprise.

Aware of this regulatory bottleneck, the Federal Government, by means of Decree 4,925 of September 19, 2003, created the Mobilization Program of the National Petroleum and Natural Gas Industry (Prominp). Outstanding among the studies performed by PROMINP, is the "Environmental Licensing Analysis of the Cycle of Petroleum and Natural Gas Activities", which indicated the need for a supplement to the existing rules regarding environmental conditions.

Notwithstanding the advances described above, the integration of the environmental vector with the E&P activities stills proves to be unsatisfactory, generating uncertainties about the feasibility of the projects, given that the

3 The Licensing Guide was released in the Fourth Round, as a result of the joint action of the ANP and Ibama, which gathered in a cartographic data base the principal information relating to the environmental resources, indicating the areas of greater environmental sensitivity and establishing guidelines for the preparation of Environmental Impact Studies related to the licensing process.

environmental guidelines that support the decision-making process continue, in their essence, directed towards the licensing and, therefore, restricted to the level of projects. The environmental licensing is not able to provide an integrated assessment of all these undertakings linked to the petroleum chain, an evaluation of the cumulative effects and the synergy of their impacts, further associated with the projects already implemented in the region.

> "It is not capable of assessing the socio-environmental transformations caused by the development of the set of projects. It is not capable of predicting if the oil is a suitable economic vocation, compatible with other vocations. It is unable, therefore, to respond to a fundamental question: in a certain region, is the exploration and production of petroleum, considering the whole chain involved, a feasibility from an environmental point of view? Under what conditions?" (Ibama, 2018)

According to the lesson of Teixeira, the insufficiency of the environmental licensing process to deal with socio-environmental issues of a strategic nature (for example, potential conflicts with other co-located economic activities or conflict between objectives of use of areas of common interest, in particular between the environmental and energy sectors), which are not previously assessed by the governmental bodies involved, has become increasingly evident by the progressive increment of E&P activities. The model adopted does not minimize the uncertainty of the investors regarding the environmental viability of the development of the oil activities in the blocks offered[4].

If the interaction of the environmental agenda and the E&P activities does not evolve, an increase of the socio-environmental conflicts associated with the uses of the natural resources and the preservation of areas of environmental interest is to be expected. This is justified, while the analyses are directed basically towards the potential for environmental damage associated with E&P activity. What one observes, both in the technical analysis process as well as in the decision-making process is the absence of studies that take into

4 It is fitting to recall the case that is emblematic of the denial of environmental licensing by Ibama involving the company, Newfield do Brasil Ltda., which had its exploration license denied by Ibama in 2005 to operate block BM-ES-20, located in the Espírito Santo Basin. Newfield filed an arbitration lawsuit against the ANP which lasted for more than ten years. Finally, the ANP was ordered to compensate the concessionaire by 5.38 million reais, for not having been able to explore the awarded block, since it was located near to the Abrolhos archipelago.

consideration a strategic assessment of the potential of impact and risk, critical factors, resulting from the implementation of an E&P activity.

In light of this situation, the incorporation of the environmental variable *ex ante* the decision-making is proposed based on a systematic and continuous procedure of assessment of the quality of the environment and of the environmental consequences resulting from alternative views and intentions of development, incorporated into initiatives such as the formulation of policies, plans and programs (PPP), to ensure the effective integration of the biophysical, economic, social and political aspects. (Ministry of the Environment, 2002). Such an instrument of environmental policy is commonly known as a Strategic Environmental Assessment.

With regard to the use of the Strategic Environmental Assessment (SEA) in the petroleum sector, international experience reveals that this instrument can be adopted by different planning and decision-making systems, being adapted to the legal reality of each country, without the risk of frustrating its purposes.

It should be remembered that SEA is applied by traditional oil and natural gas producing countries, such as the United States, Norway and Canada. Despite the differences in sectorial planning models of each country, relating to the specifics of the local legal order, the environmental variable proves to be a strategic theme to support decision-making on the offer or not of exploratory blocks. From the analyses performed by these three countries, the following common elements are observed (Teixeira, 2008):

- The incorporation of the environmental vector is not limited to the project. To the contrary, it is adopted at the time of the sectorial planning of concessions of new areas, by means of technical and scientific inputs, with clear criteria and rules, prescribed in transparent procedures;
- There is dialogue between the State, the companies and civil society, backed by systematic processes integrated into the planning;
- The State is present throughout the whole process, making efforts to mitigate the uncertainties relating to the feasibility of new E&P activities.

Finally, it must be emphasized that all the countries use structured processes of environmental assessment, with a broad participation of interested parties, *ex ante* the decision-making, seeking to foresee the socio-environmental impacts associated with the development of E&P activities. Similarly, the countries use the

environmental for the decision-making about the opening up of exploratory areas (moratorium, exclusion or exploration with special levels of environmental control).

14.2 The Brazilian experience with the use of SEA in the petroleum sector

Up to the present, the only SEA undertaken in the scope of an E&P activity was the SEA of the Camamu-Almada Basin[5] (2002-2003), promoted by the concessionaires and carried out by the team of the Interdisciplinary Environment Laboratory of COPPE, UFRJ- Lima/COPPE/UFRJ. The objective of the SEA was to assess the environmental implications of possible options of oil and natural gas exploration and production in areas of high environmental sensitivity and its cumulated socio-environmental impacts in relation to the proximity of Conservation Units and the dependence of local populations on fishing and tourism activities.

It is appropriate to point out the clear connection between the SEA with an approach that could outline the external factors resulting from the E&P activity in that region. It was necessary to contextualize socio-environmental impacts of the oil industry with the other industries, such as, for example the tourist industry. It was further necessary to understand the economic challenges, considering the needs of the E&P chain, such as integration of modes for the transport and destination of the prospected hydrocarbons.

Ii is important to note that the SEA of Camamu-Almada came about in a context of a structuring project, whose impacts of its development in the region were not foreseen nor dimensioned and whose variables would not be considered in the Environmental Impact Study (EIA). It is fitting to point out that eighteen development scenarios and 166 technological alternatives were defined for the production chain. Besides the referred to socio-environmental impacts of the productive alternatives, the potential of the environmental risk linked to them was studied.

Although the SEA of Camamu-Almada may not have directly debated the issue of sustainability, it sought to define more environmentally friendly E&P alternatives in an area of high environmental sensitivity, which had not been

5 This SEA was prepared at the request of Petrobras, El Paso, Queiroz Galvão, Ipiranga and Petroserv who contracted the Interdisciplinary Environment Laboratory of COPPE/UFRJ in 2002 to develop the study of the exploratory project. This author, however, understands that the ideal time for the elaboration of an SEA be before the offer of the areas in the auction.

the objective of any oil prospecting up to that time. In the words of Teixeira, besides the assessment of the critical factors of the E&P activities in that region, the concessionaires sought other ways of interaction with the local populations and the environmental area, upon indicating the synergies and the positive external factors resulting from the development of the granted blocks.

14.3 The SEA in the regulatory agenda

Attentive to the insufficiencies of the current model of offering blocks and of inter-institutional dialogue about the incorporation of the environmental variable into the sectorial planning of opening up areas to E&P activities, MME/MMA Inter-ministerial Regulation nº 198 was published on April 5, 2012, which instituted the Environmental Assessment of Sedimentary Areas (AAAS), disciplining its relationship with the process of granting exploratory oil and natural gas blocks, located in the offshore and onshore sedimentary basins, and with the environmental licensing process of the respective projects and activities.

One of the innovations brought by the Regulation was the definition that the process of choosing blocks to be auctioned should be preceded by an assessment based on multi-disciplinary studies, with a regional scope, which, in turn, will provide support for the strategic planning of sectoral policies in the E&P segment. Based on the analysis of the socio-economic diagnosis of a certain sedimentary area and of the identification of the potential socio-environmental impacts associated with the E&P activities, the classification of the suitability of the assessed area for the development of the referred to activities or projects will be made, as well as the definition of recommendations to be integrated into the decision-making and environmental licensing processes.

Among the objectives of the AAAS, the quest for the increase in legal security in the environmental licensing processes and a greater rationality and synergy for the development of environmental studies in the environmental licensing processes stands out, taking advantage of the data and information from the AAAS in the referred to studies.

Furthermore, the AAAS has been consecrated as an instrument of policy and environmental management suitable to back up governmental actions that consider sustainable development in the strategic planning, to the extent that it

contributes towards the classification of a certain regional space with effective or potential E&P interest.

It is necessary to point out that the referred to Regulation makes provision that the AAAS will be preceded by an Environmental Study (EAAS). This, in turn, will result in the classification of the sedimentary areas with regard to fitness for the operations of E&P, categorizing them as suitable areas, unsuitable or in moratorium[6]. It was also provided that the EAAS result in the elaboration of a reference hydrodynamic base, to be made available to the companies, as support in the modeling of oil and pollutant dispersion in the region, in the proposing of recommendations not connected to the environmental licensing process, besides a deadline for its own revision.

Furthermore, provision was made that for each AAAS an Accompanying Technical Committee (CTA) be constituted, necessarily composed by members of the ANP, Ibama and of the ICMBio, among others[7], substituting the current GTPEG. The CTA, in the course of its work, may hear from members of academia and specialists. The conclusions of the AAAS will relate just to the areas to be auctioned, thus, ensuring the continuity of the licensed activities before they are put into effect.

Although the AAAS is not linked to an environmental body, the studies produced in its sphere, as well as the decisions of the CTA, should be considered by the agencies of the National System of the Environment (Sisnama), in the environmental licensing process, with a view to the rationalization of the required studies, including the Environmental Impact Study and Environmental Impact Report (EIA/Rima).

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6 MMA/MME Regulation 198/2012: "Art. 1. (…)
IV - Suitable areas: areas whose conditions and socio-environmental characteristics, identified based on the AAAS, are compatible with petroleum and natural gas exploration and production activities and enterprises, through the use of the best practices of the industry;
V - Unsuitable areas: areas where highly relevant environmental assets are found, identified based on the AAAS, whose necessity for conservation may be incompatible with the impacts and risks associated with the oil exploration;
VI - Areas in moratorium: areas where, based on the AAAS, important gaps in scientific knowledge or relevant conflicts of use of the space and of the socio-environmental resources were identified, depending on further in-depth studies and technological development of more appropriate environmental alternatives for a decision regarding suitability for oil exploration;".

7 MME/MMA Inter-ministerial Regulation nº 621, of November 18, 2014 instituted the CTA for the AAAS of the Solimões Onshore Sedimentary Basin; MME/MMA Inter-ministerial Regulation nº 622, of November 18, 2014 instituted the CTA for the AAAS of the Sergipe-Alagoas/Jacuípe Offshore Sedimentary Basin.

It is fitting to digress here to mention the competent body to conduct the AAAS. There are those who argue that because it is a study of an environmental nature, Ibama, as the executive body of the National Environment Policies, should be the autarchy responsible for conducting this activity. It must be pointed out that there is no regulation that the environmental licensing of E&P activities depends upon the elaboration of an AAAS. There is, however, a clear provision in the Petroleum Law that the implementation of the national petroleum, natural gas and biofuels policy, contained in the national energy policy, will be an attribute of the ANP. Therefore, since the planning of the concession rounds is the responsibility of the ANP and since the AAAS is an instrument that intends to support the strategic planning of the policy for offering exploratory blocks, it makes sense that the responsibility for its implementation rightly fall on the shoulders of the agency.

14.4 The use of AAAS from the point of view of the control entities

Especially from the 11th Round of Bidding, the Preliminary Technical Opinion of the GTPEG is already beginning to show signs of limitations when it is intended to foresee the possible socio-environmental impacts and discuss the environmental variable *ex ante* the taking of a decision.

It should be noted that the Judiciary[8] and the Accounting Court of the Federal Government[9] have already expressed themselves regarding the expansion of the

8 Due to a court injunction handed down in the records of Civil Public Action nº 5005509-18.2014.404.7005, the effects of the concession agreements relating to the blocks located in the sector, SPAR-CS, of the Paraná basin, were suspended. Besides this, the Collegiate Board of the ANP, due to a court decision, annulled the signing of the concession agreement referring to block PN-T-597, located in sector, SPN-O, of the Parnaíba basin, auctioned in the 12th Round. Additionally, a preliminary injunction was granted in the records of Civil Public Action nº 080036679.2016.4.05.8500 to suspend the concession agreements that involve the exploration of shale gas by means of fracking in the Sergipe-Alagoas Basin. Finally, preliminary injunction was granted in the records of Civil Public Action nº 0030652-38.2014.4.01.3300 also to suspend exploration by fracking in the Recôncavo Basin. *All the provisional remedies granted by the Courts make the continuity of the E&P activities in the regions dependent upon the carrying out of an AAAS.*

9 Appellate Decision 3,639/2013 of the TCU (Federal Accounting Court) handed down on Dec/10/2013. Appellate Justice Rapporteur José Jorge. "(...) The adoption of the Environmental Assessment of Sedimentary Areas (AAAS) is recommended as one of the adequate instruments for the definition

dialogue about environmental feasibility in the strategic planning of the process of granting exploratory blocks.

Recently, Ibama itself issued an opinion[10] that recognizes the strategic importance of the use of the AAAS through the levels of sectorial planning to mitigate risk for the concessionaires in the fulfillment of the technical requirements for the elaboration of the EIA. The Opinion further emphasizes that only a strategic environmental assessment would be capable of providing adequate support for a better technical analysis at the time of the environmental licensing process.

14.5 Conclusion

International experience reveals that the opening of areas of a new frontier for E&P activities, of notorious socio-environmental sensitivity or of a high biodiversity protection interest is far from being a decision exempt from conflicts of interest. However, the argument about strategic development objectives such as the guarantee of national energy security, diversity of the energy matrix and a long-lasting self-sufficiency in oil and natural gas, can lead to the decision of offering areas for E&P without needing to exclude other intended uses or other economic activities.

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of the conditions of the surrounding area for use of hydraulic fracking practices in horizontal wells in the basins of interest (...) 53. The overall analysis of this information unmistakably points to a lack of adequate planning with respect to the treatment of the issues of environmental impact of the production in non-conventional areas, principally with regard to the absence of records of debates on the theme with a focus on the creation of rules."

10 Technical opinion nº 73/2018-COEXP/CGMAC/DILIC: "If performed beforehand, the assessment would resolve certain issues with more accuracy that would provide greater certainty, effectiveness and celerity in the environmental licensing process. However, up to the present date, the AAAS had not been implemented in any area of the country. This Coordinating Office understands that for areas of notorious socio-environmental sensitivity and of a new frontier for the oil industry, especially where there are not yet any production facilities, the AAAS becomes a priority and essential for adequate decision-making. This reflection does not have the objective – nor could it have – of affirming that exploratory drilling environmental licenses must not be issued in such situations until a strategic environmental assessment, such as the AAAS may be performed. Actually, the intention is to reinforce its importance and to highlight the greater responsibility of the technicians in analyzing an environmental license without the support of a strategic environmental assessment. In this sense, it is considered fundamental to perform the AAAS at least before the production environmental licensing".

That being so, the Strategic Environmental Assessment is proving to be a relevant instrument for national energy and environment planning, by harmonizing the objectives of energy generation and environmental conservation and sustainability, besides contributing to a dynamism of the environmental licensing process. Given the above, it is estimated that the correct incorporation of the AAAS into the planning for offering E&P blocks may contribute to greater predictability and simplification of the licensing, reinforcing legal security for the businesses of the Brazilian oil and gas industry.

PART IV

TAX ISSUES

15. Taxing power and international regulation of oil and gas exploration in areas beyond national jurisdiction

Luiz André Nunes de Oliveira

There are two extremely sensitive aspects that relate to the topic: the question of sovereignty and the economic importance of oil exploration activity.

To analyze the scenario, one must take into consideration: i) that the revenues coming from the exploration of oil and gas involve significant amounts; ii) that fossil mineral assets are not geologically distributed equally in the territories of countries; and iii) that the exploration of oil and gas has a potential for causing environmental damage.

Taxing power is one of the expressions of sovereignty. It is the power to create laws that institute taxes. It involves the ability to legislate, supervise and collect taxes.

It is in this panorama that the need arises to delimit the areas that are under the jurisdiction of the coastal countries and the areas that extend beyond their jurisdiction in order to avoid conflicts.

There is always tension between States when it comes to issues of sovereignty. Especially when it comes to resources from the sea, conflict has always been a constant. This is the reason for the effort of the international community to promote broad and enduring debates that culminated in the Third Unclos – United Nations Convention on the Law of the Sea, known as the Montego Bay Convention[1] of 1982, the purpose of which is to regulate and set standards for legal relations at sea.

1 Acronym in English: Unclos - United Nations Convention on the Law of the Sea.

15.1 The Montego Bay Convention on the Law of the Sea

Unclos arose from the necessity to elaborate new rules on the Law of the Sea as a result of the geopolitical structure of the period and was received with enthusiasm by developing countries, animated with the prediction that they could participate in the product of the exploration of the wealth in areas of the sea that would come to constitute a common heritage of humanity.

The Third United Nations Convention on the Law of the Sea, with the presence of 164 States (members and non-members of the UN), was able to adopt a Convention on the Law of the Sea, through the vote of 130 States in favor, 4 against (United States of America, Venezuela, Israel and Turkey) and 18 abstentions, having been signed in Montego Bay, Jamaica, on December 10, 1982. Currently, with the implementation of the Protocol of Part XI, in 1994, it has 162 ratifications[2].

Brazil, a signatory of the Convention, as a consequence, enacted Law nº 8,617/1993, which determined, internally, a territorial sea of just 12 nautical miles and revoked Decree-Law nº 1,098/1970, which unilaterally determined a territorial sea of 200 nautical miles.

15.2 Law of the sea: International oil and gas exploration regulation

The geographical indivisibility of the sea is opposed to the legal diversity of the waters that comprise it, which demands the regulation of the legal implications resulting therefrom.

The exploration of oil and gas and other minerals, possesses specific regulation based on the legislation of each country which must be observed in the places where the countries hold full sovereignty.

However, the exploration of oil and gas in areas under international jurisdiction obeys a differentiated regulation of the norms that regulate the exploration of these materials in areas under jurisdiction of the countries.

It is necessary, therefore, to identify which are the areas under national jurisdiction and the areas under international jurisdiction.

2 Data from 2012.

15.3 Maritime spaces under national jurisdiction

15.3.1 Territorial sea

According to Unclos, the sovereignty of the coastal Country extends, beyond its territory and inland waters, to an adjacent sea zone designated by the name of territorial sea[3] [e] [4]. It includes the waters, the sea bed, the respective subsoil, and also the overlaying air space. With the exception of the right of innocent passage (continuous, rapid and peaceful) in favor of the ships of any Country.

Thus, there are no doubts that the coastal Country has taxing powers over oil and gas exploration activity in the area known as territorial sea as a result of the exercise of its full sovereignty in this area.

15.3.2 Contiguous zone

The contiguous zone is the area adjacent to the territorial sea, in which the Country can take the necessary supervisory measures to avoid violations of the laws and customs, tax, immigration and sanitation regulations in its territory and to repress legal and regulatory infractions in its territory and in its territorial sea in general.

The 1982 Convention refers to the contiguous zone, resuming these prerogatives of the coastal State and establishing the limit of twenty-four nautical miles counting from the same baseline of the territorial sea in the same sense as the Brazilian national legislation[5].

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3 Law 8,617/1993: "Art. 1. The Brazilian territorial sea is a belt of sea twelve nautical miles in breadth, measured from the low-water line along the Brazilian coast, as marked on large-scale charts officially recognized in Brazil".

4 Unclos: "Art. 2.1. The sovereignty of the coastal State extends beyond its territory and internal waters and, in the case of an archipelagic State, of its archipelagic waters, to an adjacent belt of sea, described as the territorial sea".

5 Law nº 8,617/1993: "Art. 4. The Brazilian contiguous zone is a belt of sea which extends from twelve to twenty-four nautical miles from the baselines from which the breadth of the territorial sea is measured".

15.3.3 Exclusive economic zone

The exclusive economic zone encompasses the contiguous zone and extends up to the limit of two hundred nautical miles starting at the baselines from which the breadth of the territorial sea is measured.

According to Unclos, in this area, the coastal Country has sovereign rights to exploit the production of energy derived from the water, currents and winds, the establishment and use of islands, installations and structures, investigation or scientific research, the protection and preservation of the marine environment, and principally, the exploitation of the natural resources[6] found on the seabed and in the subsoil[7].

15.3.4 Continental shelf

The continental shelf is a geological concept that refers to the layers of rock that project from the continental mass into the sea and are covered only by a layer of water. It is a smooth extension that begins at the coast, where the firm land ends, and goes out a certain distance from the coast beyond the territorial waters, where it declines steeply until it falls off into the extreme depths of the high seas.

The coastal State enjoys the right to exclusively exploit the natural resources existing in the continental shelf and no-one else is authorized to do so without the consent of this State.

15.4 Maritime areas under international jurisdiction

There are areas adjacent to maritime areas that are under international jurisdiction, these areas not being subject to or under the jurisdiction of any

6 Unclos – uses the term *resources* meaning all the solid, liquid or gaseous mineral resources situated in the Area, seabed or subsoil. When extracted they are denominated *minerals*.

7 Law 8,617/1993: "Article 7. In the exclusive economic zone, Brazil has sovereign rights for the purpose of exploring and exploiting, conserving and managing the natural resources, whether living or non-living, of the waters superjacent to the seabed, of the seabed and its subsoil, and with regard to other activities for the economic exploration and exploration of the zone".

individual country, and are considered a common heritage of humanity, they are the Area and the High Seas.

15.4.1 The high-seas

Beyond the limits of the continental shelf, the portions of corresponding water is part of the high-seas, but the seabed and marine subsoil (Area) have their own legal system.

In the high-seas, there is no exercise of the right of sovereignty. It covers all the maritime parts not included in the exclusive economic zone, in the territorial sea or in the internal waters of a Country, neither in the archipelagic waters of an Archipelagic State[8].

Freedom on the high seas includes, for all States, without discrimination, the freedom of navigation, overflight, the laying of submarine cables and pipelines, the construction of artificial islands, freedom of fishing and scientific research, being unacceptable for any state to attempt to subject any part of the high seas to its sovereignty.

On the high-seas, outside of the limits under national jurisdiction, the freedom to construct installations is limited for all States, to the structures not related to the exploitation of the natural resources of the Area. That is, all the activities relating to exploration must be submitted to the examination of the International Seabed Authority.

15.4.2 The area

The Montego Bay Convention defines Area as the seabed in the region of the marine depths. It is a space (terrestrial) considered international, which is not subject to the territorial sovereignty of any Country.

The so-called Area is the land space that makes up, broadly speaking, the soil and the sub-soil subjacent to the high seas and that are the extension of the continental shelf considered to be the common heritage of mankind. Humanity is the holder of the rights of exploration of the wealth that may come to be found in this area.

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8 Archipelagic State means a State totally constituted of one or several archipelagos, and may include other islands.

15.4.3 The authority and the company

The Convention instituted and regulated in its Part XI[9] the International Authority of the Marine Depths[10] to care for the administration of the Area. Given responsibility for regulating, supervising and managing the exploration of the resources existing in this space.

On the one hand, the Authority provides institutional support of the system relating to the natural resources of the Area. On the other hand, the Company[11] is responsible for the operation of the activities in the Area and for any partnerships or joint ventures with the Countries for effectively performing the activities in the Area.

The exploration of resources of the Area will depend upon a plan of work for the Company, which, once approved, will be included in a contract between the Authority and the Company.

Thus, the exploration in itself of the natural resources existing at the bottom of the seas is performed by the Company under the administration of the Authority and the participation of any member-State of Unclos.

15.5 The brazilian continental shelf and the possibility of its extension

As a general rule, Unclos assures to each coastal Country up to 200 nautical miles to the limit of its natural extension. However, there is a provision in article 76, of Unclos that establishes the expansion of this shelf up to a maximum limit of 350 nautical miles from the baselines of the coast, provided that it possesses a portion of the submerged continent beyond the 300 nautical miles and it is recognized by means of an analysis of a UN agency denominated Commission on the Limits of the Continental Shelf (CLCS).

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9 Internalized by Brazil through Decree 6,440/2008.

10 International Authority of the Marine Depths, endowed as an international legal entity, it is composed of the bodies: Assembly, Council and Secretariat. It is participated in by all the member-States of the Montego Bay Convention.

11 Company is an agency of the Authority endowed with an international legal personality that directly performs the activities in the Area, including transportation, processing and marketing of the resources extracted in the Area.

Any request for extension of the continental shelf must be grounded on technical information that demonstrates that the ocean floor is in compliance with the desired extension. In any case, the limit of the continental shelf must not exceed 350 nautical miles from the baseline from which the width of the territorial sea is measured.

The role of the CLCS is relevant, since the majority of the States will not use its services. However, the effects of the decisions and recommendations of the Commission will have an impact on the whole of international society. This occurs because all the expansion of the continental shelf of a coastal Country, beyond the limit of 200 nautical miles, has as a consequence, the reduction of the Area, considered as the common heritage of mankind. It is for this reason that the Commission suffers pressure from two sides. On one side, that of the coastal States that seek to maximize their claims and, on the other, the States less geographically favored [12] that have no interest in an increase of the continental shelves of the coastal States.

Brazil was one of the pioneers in submitting claims for the expansion of the continental shelf. Leplac[13] performed a survey of data, prepared a proposal for the expansion of the Brazilian continental shelf. The Brazilian application claims an area of 960 thousand km^2 along its coast.

In 2004, Brazil filed and defended its claim before the CLCS and a sub-committee of experts. In 2007, after analysis, the CLCS did not agree with about 190 thousand km^2 of the Brazilian claim, approximately 19% of the area claimed for extension. In 2008, there began a new phase of geophysical data acquisition from the Brazilian continental margin.

As a consequence of the partial denial of the CLCS, Brazil, unable to accept the result, decided to prepare a Revised Proposal[14] as yet incomplete of the analysis made by the CLCS.

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12 The States without a coast, that do not have a continental shelf or without a possibility of expanding it.

13 Leplac – Plano de levantamento da plataforma continental Brasileira (Survey plan of the Brazilian continental shelf), is a Government program instituted by Decree 98,145/1989, coordinated by the Inter-ministerial Commission for the resources of the Sea (CIRM), the purpose of which is to establish the external limit of the Brazilian continental shelf.

14 The Revised Proposal was divided into three regions: South Region (submitted and presented in 2015 and defended in 2017, under analysis at the CLCS); Equatorial Region (Submitted in 2017, to be presented in Mar 08, 2018); and Oriental Region (in the preparation phase, expected to be submitted in July, 2018).

Consequently, in the current legal scenario, the Brazilian continental shelf is limited to the 200 nautical miles established in the Montego Bay Convention due to the fact that the Brazilian claim for its expansion has not been considered definitively by the UN Commission.

15.6 Taxing power in the extension of the continental shelf and the collection of the international contribution (royalty) provided for in article 82 of Unclos

If, on one side, Unclos authorizes the extension of the continental shelf[15], on the other side, in compensation, it makes provision for the collection of a contribution[16] from the coastal State that exploits the non-living resources of the extended shelf, through the Authority, based on criteria of fair distribution to meet the needs of the developing countries.

This contribution has the nature of a royalty for the exploitation of other's heritage and is grounded on the fact that, not having an increase of the limits of the continental shelf, the resources existing in the space beyond the 200 nautical miles would be part of the Area under international jurisdiction and considered a common heritage of mankind, and its exploitation should take place for the benefit of all through a Common Fund for Humanity.

The one obligated to pay this royalty is the coastal Country that possesses an extended shelf which can pass this obligation on to the effective explorer.

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15 Article 76 of Unclos.

16 Unclos: "Article 82.1. The coastal State shall make payments or contributions in kind in respect of the exploitation of the non-living resources of the continental shelf beyond 200 nautical miles from the baselines from which the breadth of the territorial sea is measured.
Article 82.2. The payments and contributions shall be made annually with respect to all production at a site after the first five years of production at that site. For the sixth year, the rate of payment or contribution shall be 1% of the value or volume of production at the site. This rate shall increase by 1% for each subsequent year until the twelfth year and shall remain at 7% thereafter. Production does not include resources used in connection with exploitation.
Article 82.3. A developing State which is a net importer of a mineral resource produced from its continental shelf is exempt from making such payments or contributions in respect of that mineral resource.
Article 82.4. The payments or contributions must be made through the Authority, which shall distribute them to Member States in this Convention, based on fair distribution criteria, taking into account the interests and needs of developing States, particularly the least developed and the land-locked ones".

Article 82.2 of Unclos says that the collection of the royalty will be put into effect annually, as from the 6th year of production at the rate of 1%, which will increase 1% annually up to the 12th year and from then on it will be maintained at 7%. The referred to royalty does not have the nature of a tax.

The royalties will be distributed by the Authority between the member Countries of the Convention based on fair distribution criteria and aimed at meeting the needs of the developing countries.

Thus, in the extension of the continental shelf beyond the 200 miles two jurisdictions will co-exist for collection of contributions in the exploration of non-living natural resources. In addition to the collection of the royalty, there will be due to the coastal Country, holder of the extended shelf, all the levies provided for in the internal legislation of the country, applicable to the activities related to the exploration of natural resources in the sea.

16. Taxation of activities developed in maritime waters: Controversies regarding the legitimacy of state and local taxes

Michel Siqueira Pereira Batista

16.1 Introduction

The Montego Bay Convention grants the signatory States the freedom to economically exploit maritime areas (including natural resources) located within the exclusive economic zone and continental shelf adjacent to their territories, subject to the right of navigation of other countries.

The exercise of sovereignty on these terms authorizes, in theory, the implementation of the taxing power of the Coastal State in maritime waters.

It happens, however, that, in order to enact and collect taxes, federative entities, and especially in the case under examination, that is, the states and municipalities, must obey certain limits and conditions set forth in the Federal Constitution. Non-compliance with said requirements, on the other hand, leads to the complete unconstitutionality and unlawfulness of the collection of taxes.

The purpose of this essay is to briefly analyze the legitimacy of the collection of taxes by states and municipalities on activities undertaken in maritime waters, notably in the exclusive economic zone and continental shelf.

As will be seen, the exercise of taxing power by these entities in maritime waters is questionable under the current conditions, which potentially affects the levy of the most relevant state and local taxes: ICMS[1] (levied on the circulation of goods and provision of interstate and intermunicipal transportation services, as well as on communication services) and the ISS[2] (levied on services in general).

1 Brazilian VAT on merchandises and certain Services.

2 Tax on Services of Any Nature.

16.2 Taxing power

Taxing power concerns the competence expressly assigned by the Federal Constitution to each federative entity (Union, States, Federal District and Municipalities) to enact taxes.

It is a prerogative that confers upon the federative entities broad powers, consisting of freedom to take decisions of a clearly political nature regarding the creation of taxes, as well as the scope of their levy, always obeying, of course, the criteria for division and limits of the power of taxation determined by the Federal Constitution.

In this regard, the Federal Constitution promulgated in 1988 opted for a strict criteria for the allocation of taxing powers, according to which the constitution itself expressly and exhaustively establishes the materiality (taxable events) over which the Union, States and Municipality may levy taxes.

That being said, the taxes under jurisdiction of each federative entity are as follows:

Federative Entity	Taxes
Federal Government	Import Duty (art. 153, I) Export Duty (art. 153, II) Income Tax (art. 153, III); IPI[3] (art. 153, IV); IOF[4] (art. 153, V); ITR[5] (art. 153, VI); IGF[6] (art. 153, VII); Residual Tax (art. 154, I); Extraordinary War Tax (art. 154, II);
States	ITCMD[7] (art. 155, I); ICMS (art. 155, II); IPVA[8] (art. 155, III);

3 Tax on Manufactured Products.

4 Tax on Credit, Foreign Exchange and Insurance Transactions, or those related to Bonds or Securities.

5 Rural Real Estate Tax.

6 Wealth Tax.

7 Estate and Gift Tax.

8 Tax on Vehicles.

Federal District	ITCMD (art. 155, I); ICMS (art. 155, II); IPVA (art. 155, III); IPTU[9] (art. 147 coupled with 156, I); ITBI[10] (art. 147 coupled with 156, II); ISS (art. 147 coupled with 156, III);
Municipalities	IPTU (art. 156, I); ITBI (art. 156, II); ISS (art. 156, III);

The Federal District accumulates the powers assigned to the States and Municipality. Regarding the Territories[11], the state taxes and, if the Territory is not divided into Municipalities, cumulatively, the local taxes, fall to the Union.

16.3 Activities in maritime waters: Controversies

One of the intrinsic limits to the exercise of taxing power is the principle of territoriality, which presupposes that federative entities can only tax activities whose taxable event takes place within their territory.

It is an instinctive rule, deriving from the constitutional system itself, but, due to its importance, it is expressly reproduced in article 102 of the Brazilian Tax Code (CTN), which recognizes the possibility of extraterritorial effects of the laws only in specific cases (established in agreements or Federal Complementary Laws) under the following terms:

> "Article 102. The tax legislation of the States, the Federal District and the Municipalities is in force in Brazil outside their respective territories, within the limits that the agreements they entered into recognize the extraterritoriality, or as provided by this or other general laws issued by the Union."

9 Urban Real Estate Tax.

10 Tax on Inter Vivos Conveyance of Real Estate.

11 The Territories, in brief, are federative entities without administrative autonomy, which are part of the Union. There are currently no Territories in Brazil. The last examples were Fernando de Noronha (incorporated into the state of Pernambuco), Amapá and Roraima, which received the status under the Constitution of 1988.

It occurs, however, that the Brazilian legal system does not expressly define whether the maritime waters make up or not the territories of the coastal states and municipalities, which raises discussions on the taxation of activities undertaken in this region.

The matter, of extreme relevance (especially after the discovery of the pre-salt, which generated a considerable increase in economic activities in maritime waters), will be adjudicated by the Federal Supreme Court within the scope of the Direct Action of Unconstitutionality (ADI) nº 2.080/RJ.

The ADI was filed in 1999 by the National Confederation of Transport with a petition for preliminary injunction to challenge the constitutionality of the provisions under the Constitution of the State of Rio de Janeiro, as well as the provisions of a local law that authorized and instituted, respectively, the collection of ICMS on interstate and intermunicipal transportation provided between oil rigs.

The preliminary injunction was denied in 2002 and since then the matter has been pending a final and unappealable decision. It is worth noting, however, that, after a long period without procedural changes, the case has recently been prosecuted again and, since 2017, the rapporteur's vote has been drafted (held by the Judge-Rapporteur Gilmar Mendes), so it is expected that soon the matter will be adjudicated.

Although the subject matter of the ADI is restricted to ICMS on interstate and intermunicipal transportation services, the content of the discussion is similar to that of the issue involving the collection of ISS by the municipalities (except for some peculiarities). Thus, it is expected that the outcome of this judgment will bring repercussions also on the ISS.

Having overcome the issue about the possibility, in the abstract, of the exercise of taxing power by the states and municipalities in the projection of the respective territories over maritime waters, it is still necessary to discuss (especially if this issue is not addressed by the ADI) the validity of the criteria currently applied, mainly by municipalities, to support the application of their legislations.

In view of the absence of express and specific regulations on criteria and methodologies for projecting the territories of states and municipalities over maritime waters, municipalities in particular have borrowed the parameters established by Law nº 7,525/1986, regulated by Decree nº 93,189/1986.

It happens that, in addition to the fact that they do not provide for taxation matters (the rules set out therein are intended to define the projections of the territories over the maritime waters for the purpose of paying royalties to the municipalities facing the production areas), the existing criteria are not absolute, reason why they raise doubts in its application, even allowing the overlap of areas.

In other words, according to the method applied (parallel lines or orthogonal lines), the same area can be assigned to more than one municipality. A paradigmatic example in this regard is the Original Civil Action (ACO) 444, which discusses the demarcation by the Brazilian Institute of Geography and Statistics (IBGE) of the interstate maritime boundary between Santa Catarina and Paraná for the purpose of distributing royalties.

Beyond the discussion on the validity, for tax purposes, of the methods and criteria applied with a view to distributing royalties, it is clear the fact that they are parameters set forth in the Ordinary Law, while the Constitution of 1988 (art. 146, I[12]) expressly establishes that the appropriate vehicle to provide for conflicts of jurisdiction, with regard to tax matters, is the Complementary Law.

Furthermore, the already mentioned article 102 of the CTN leads to the same conclusion by conditioning the extraterritorial effects of state rules (which would be the case, unless the Constitution itself recognized the projection over maritime waters as territory of states and municipalities – which does not appear to occur, at least expressly) upon the previous issue of *general laws issued by the Union* – which, under terms of article 146 III[3] of the Constitution, is also reserved to the Complementary Law.

Lastly, especially in the case of ISS, it should be noted that, even the alleged criteria provided for in Complementary Law nº 116/2003, do not seem sufficient to completely settle the doubts.

In effect, paragraph 3 of article 3 provides that, regarding services rendered in maritime waters, "the taxable event that generates the taxation is deemed to have occurred at the location of the *rendering establishment*".

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12 "Article 146. The complementary law is intended to:
I – provide for the conflicts of jurisdiction, with regard to taxation matters, between the Union, the States, the Federal District and the Municipalities;
(...)
III – establish general rules concerning tax legislation, especially on:"

Article 4 of same law, in turn, defines *rendering establishment* as "the place where the taxpayer undertakes the activity of rendering services, permanently or temporarily, and which configures economic or professional unit".

Based on such definitions, it can be argued that in situations where the provider has an establishment in maritime waters, the service will be deemed to be provided therein. However, the exercise of a taxing power by municipalities in maritime waters seems to be controversial, as discussed above.

Furthermore, it would be an error, within this context, to claim jurisdiction for the municipality where the service provider is domiciled (location of the head office on the continent), hence the header of article 3 of Complementary Law 116/2003[13] *establishes that the service will be deemed to be rendered at the place of domicile (head office) only when there is no characterization of a rendering establishment at the location where the service is effectively rendered.*

It should be noted that the situation proposed above is not completely beyond the reality, since it is possible to identify municipalities understanding that there is economic or professional unity (and, therefore, an establishment), for example, on the rigs where certain services are rendered, as well as others considering that taxes are due at the location where the provider's head office is registered.

16.4 Conclusion

Having made the clarifications above, one notices that many doubts remain regarding the taxation by states and municipalities on activities undertaken in maritime waters.

The spectrum of this environment of uncertainty is wide and ranges from the scenario in which no state or municipality would have the legitimacy and jurisdiction to collect taxes within this space, to the point where multiple states and municipalities may regard themselves as having jurisdiction to tax the same event.

13 "Article 3. The service is deemed to be rendered, and the tax due, at the location of the rendering establishment or, in the absence of an establishment, at the location of the provider's domicile, except in the cases provided for in items I to XXV, when the tax will be due locally:"

The ideal solution, of course, would be to issue a Complementary Law properly addressing all the controversial aspects mentioned above.

Meanwhile, taxpayers are left to monitor the course of the controversies – specially the outcome of ADI judgment nº 2,080/RJ – in order to reassess, if necessary, the treatment given to their operations, as well as to analyze the feasibility of preventive measures with a view to securing the full benefit of any understanding that is favorable to them.

17. Concept of input in the oil industry and its repercussions on IPI, ICMS, PIS and Cofins

Breno Ladeira Kingma Orlando

Some taxes levied on the production chain of companies have a credits and debits system. The taxpayer may deduct, from the amount due of a tax on their sales, credits related to their expenses with services and goods acquired in previous stages.

The legislation of each tax determines which expenses will give a right to this credit.

As a general rule, raw materials that make part of the end product (iron ore used in the manufacture of steel, for example) always give a right to credit.

Doubts occur in relation to goods that are not integrated into the end product, but which are essential for the production process (electrical power, fuels and machines, for example). In relation to these items, each Brazilian tax has its own rules.

17.1 Tax on Manufactured Products (IPI)

IPI, levied on the sale of products that underwent an industrialization process, has very restrictive rules for the use of credits. According to the IPI rule, expenses with raw material, intermediate goods and packaging material give a right to credit.

Following this reasoning, according to the official positioning of the Federal Revenue Department of Brazil (RFB), voiced by Cosit opinion 65/79, only those items that aggregate into the end product (raw material) or that have physical contact with the end product and suffer wear, damage and loss of their characteristics throughout the production process (intermediate goods) give a right to credit. Despite that, various intermediate goods are, most of the time,

understood by the RFB to be fixed assets of the company, and therefore do not give a right to credit.

17.2 Tax on the Circulation of Goods and Services (ICMS)

ICMS, a kind of state VAT/IVA, has a broader spectrum of credits than IPI. The following items generate credit, according to Complementary Law 84/1996: Raw Material, Intermediate Goods, Packaging Material, Goods for Use and Consumption (office supplies, for example) as from the year 2020, fixed assets of companies (machines for example) at the proportion of 1/48, power, communications and transportation.

At the state level, as goods for use and consumption do not yet give a right to ICMS credits, companies suffer with inspections always aimed at reclassifying goods with an evident participation in the production process as if they were goods for use and consumption. For illustration purposes, refractory goods used in the steel industry to *line* the *pans* and prevent high temperature products from *sticking to* or damaging structures, are equated to goods for use and consumption by state inspectors.

In the oil industry, the problem gets worse. As oil is extracted from underground and it is not, as in the transformation industry, a *sum* of raw materials that generate a new product, the States have been adopting a mistakenly restrictive position[1]. Credits of various intermediate goods are disregarded under the argument that there was no physical contact with the

1 The restriction of credits in the extraction industry is repeated in the mining, pulp, agriculture, livestock and other industries. By way of example, see the decision below in a lawsuit related to the use of explosives in the cement industry:
"(...) USE OF ICMS CREDITS. EXPLOSIVES FOR EXTRACTION OF LIMESTONE USED IN THE MANUFACTURE OF CEMENT. NON-CUMULATIVENESS. ATTORNEY'S FEES. In the specific industrialization process performed by the appellant – which manufactures cement from the extraction of limestone, exercising all the required operations – the explosives for extracting said mineral must be considered intermediate goods in the manufacture of cement, under the terms of Normative Instruction DLT/SER nº 01/86, because, although they do not integrate into the new product, they are immediately and fully consumed during the course of the industrialization. Under the aspect of the circulation of goods, the entry of the explosives needed for the extraction of limestone and the exit, from the same establishment, of the end product, which is cement, are perceived, the use of ICMS for the inputs being applicable because of the principle of non-cumulativeness due on this linear production line. (...)"
(TJMG, Case n. 1.0290.95.000773-9/001, Judge Rapporteur ALBERGARIA COSTA, Court Register of November 04, 2008)

product extracted. For example, in appeal *5821 of the Council of Taxpayers of the State of Rio de Janeiro, the majority of votes decided that* "The drilling fluid is a consumption material, used in oil exploitation and further disposed of as an effluent, not generating any right to ICMS credit appropriation".

It is noteworthy that the matter is not unanimous among the State Taxpayer Councils. In the same ruling, one of the votes was in the sense that "The drilling fluid is an intermediate product directly employed in the production process, without which it is impossible to obtain the end product, therefore, it is valid to use ICMS credit".

The logic above is repeatedly applied to countless items acquired by the oil and gas industry. The matter will only be resolved, in our opinion, when the national complementary legislation is altered so that the recording of credits corresponding to such items is expressly guaranteed.

Meanwhile, the companies must get ahead of the game and demonstrate, by means of technical reports, the effective participation of each of the products acquired in oil exploitation and production, so that the chance of success in a possible judicial or administrative lawsuit may be increased.

17.3 Income Tax

According to the income tax legislation, every usual expense needed to obtain the revenues of the taxpayer can be deductible. Therefore, for income tax purposes, each and every company expense, provided it is necessary, cannot be disregarded by the inspectors. Thus, for income tax purposes, the concept of input is almost unrestricted.

17.4 PIS and Cofins contributions

PIS and Cofins contributions are levied on the companies' revenues. The legislation that governs these taxes allows for a broad range of credits over the taxpayer's expenses, which will be deducted from the amount due of the tax:

- goods acquired for resale;
- goods and services, used as *input* in the rendering of services and in the production or manufacture of goods or products destined for sale;

- electrical power and thermal power consumed in the premises of the legal entity;
- rents of buildings, machinery and equipment, paid to a legal entity, used in the company's activities;
- amount of the compensations of lease-purchase agreement operations of the legal entity (except when opting for Simples (taxation system));
- machinery, equipment and other goods incorporated into the fixed assets, acquired or manufactured for lease to third parties, or for use in the production of goods destined for sale or in the rendering of services;
- buildings and improvements in owned or third-party real properties, used in the company's activities;
- goods received in return, the sales revenue of which may be included in accounts receivable;
- storage of goods and freight in the sales operation of inputs and goods acquired for resale when the burden is borne by the seller;
- transportation voucher, meal voucher or food voucher, clothing or uniforms provided to the employees (by a legal entity exploiting the activities of cleaning, conservation and providing of maintenance services); and
- goods incorporated into the fixed assets, acquired to be used in the production of goods destined for sale or rendering of services.

In relation to the above items, the doubt that was still pending in the legislation was the definition of a concept of input for the purposes of taking credit. What would that concept be? The one from IPI, ICMS or Income Tax.

The Brazilian Federal Revenue Department wasted no time and published a regulation (Normative Instruction 247) to bring into PIS and Cofins the concept of restrictive physical credit of IPI. According to the tax authority, *the following are seen as inputs*:

> "I - those used in the manufacture or production of goods destined for sale:
> a) raw materials, intermediate goods, packaging material and any other goods that suffer alterations, such as wear, damage or loss of physical or chemical properties, because of action directly exercised on the product being manufactured, provided they are not included in the fixed assets;

b) services rendered by a legal entity domiciled in the Country, applied or consumed in the production or manufacture of the product;
II - those used in the rendering of services:
a) goods applied or consumed in the rendering of services, provided they are not included in the fixed assets; and
b) services rendered by a legal entity domiciled in the Country, applied or consumed in the service rendering."

When examining the cases notified by the inspection, however, the first judicial and administrative lawsuits either tended towards the concept of IPI, or approached that of the income tax.

Lastly, the prevailing line of interpretation proposes that only goods and services deemed indispensable (essential) to the production process or service rendered, without which the end product/service could not be completed/rendered, should be treated as inputs. In this case, a direct contact between the good or service and the production process would not be required, but neither would the need, normality and common practice that give rise to the deductibility of the expense be enough for income tax purposes.

This last line of reasoning seems to have been adopted by the Superior Court of Justice, under the systematics of Repetitive Appeals (Resp 1.221.170/PR).

Although there are still some doubts as to the application, in the material case, of the requirements advocated by this chain of thought (such as essentiality, relevance, indispensability and importance), notably by reason of its subjectivity, we feel that the third position will prevail.

In this sense, we come to indicate below which expenses are, in our opinion, essential, relevant, indispensable and important in the oil and gas industry. In relation to such expenses, we understand that the PIS and Cofins credit must be guaranteed uncontested. Likewise, in our opinion, the ICMS credit of goods applied in the stages below must also be admitted by the inspectors:

17.5 The operation of the industry

As already broadly discussed, the oil and gas industry is divided, for regulatory and didactic purposes, into the stages of exploration, development and production.

These three major concepts, however, include a well-defined series of industry activities:

- Acquisition and Processing of seismic data; Imaging of Reservoirs; Data management; Geophysical equipment;
- Onshore and offshore drilling rigs; Workover rigs;
- Drilling bits and muds; Control of Solids; Well Tools; Rent of tools; Fishing Services; Profiling;
- Casing and piping services, inspection of piping, pressure pumping, cementing and completion equipment, production tests;
- Offshore Engineering and Infrastructure;
- Artificial Extraction, subsea and surface equipment, maintenance of wells, special chemicals, compression services;
- Plugging and abandonment/decommissioning, effluent treatment and disposal and cleaning services;
- Removal and/or scrapping of installations, monitoring of liabilities;
- Logistical and maritime support in all stages.

The analysis of the procedures listed above indicates that all these activities are the core business of the oil industry. All of them are inextricably connected and imbricated. The division mentioned above into exploration, development and production, as said, is only for purposes of better visualization, but the fact is that they may be considered one single thing. Therefore, in our opinion, all expenses with services and goods applied to the above procedures are unquestionably inputs for the purposes of defining the recording of credits. Obviously, in some cases, the goods applied in the stages will be considered as assets by reason of their useful life and accounting classification. In other cases, as intermediate goods. However, under no circumstances may they be reclassified by the inspections as items for use and consumption.

Following this path, companies need to examine their expenditure profile in order to parameterize their taking of credits. Obviously, they must always take into account that the tax authorities insist on applying to the oil industry an extremely restrictive position as to the taking of credits.

Some examples of expenses that must be subject to analysis and discussion by the companies providing services and operators in the industry, as the case may be:

- Subcontracting for performance of the contracted object;
- Technical studies contracted from third parties make the objective of the contractual feasible;
- All services contracted to ensure the safety of the service;
- All services contracted to ensure the quality of the performance;
- If there is supply of merchandise, all goods and services needed for the supply;
- All amounts that the company legally has to incur to render the service (special clothing, Personal Protection Equipment – PPE);
- All goods essential for providing the services (food and water for embarked crew);
- Maintenance of equipment;
- Telecommunications;
- Transportation to the platform;
- Movement of equipment and goods needed to provide the service;
- All geological studies and services contracted for the exploration;
- All goods acquired and services contracted to ensure the safety of the operation (environmental and civil liability insurance, among others);
- All products used in the exploration (drilling fluid, mud, bits), in the development (cementing), maintenance (compression services) and decommissioning of wells (treatment of effluents, environmental recovery).

Therefore, the characterization of each of the items above as inputs will allow the company to have fair and efficient tax regulations.

17.6 Final considerations

Far from exhausting the topic, the purpose of this article was to present a general overview of the taking of credits and the concept of inputs in the industry. A large part of the understanding we currently have in our office regarding the sector is due to our dear partner José Carlos Ribeiro Filho, one of the greatest experts on the subject that I have the pleasure of knowing. In this sense, I register here all my great admiration for his intelligence and friendship.

That being said, some tax reform proposals are in the sense of merging IPI, ICMS, PIS and Cofins, so that a single IVA/VAT style value-added tax may be created. Still in this line, there are those who defend that credit be unrestricted, apart from physical credit and closer to financial credit.

Obviously, in case the proposal is approved, the enlargement of credits will have the consequence of increasing the tax rate and the concept of input will lose its importance for a time.

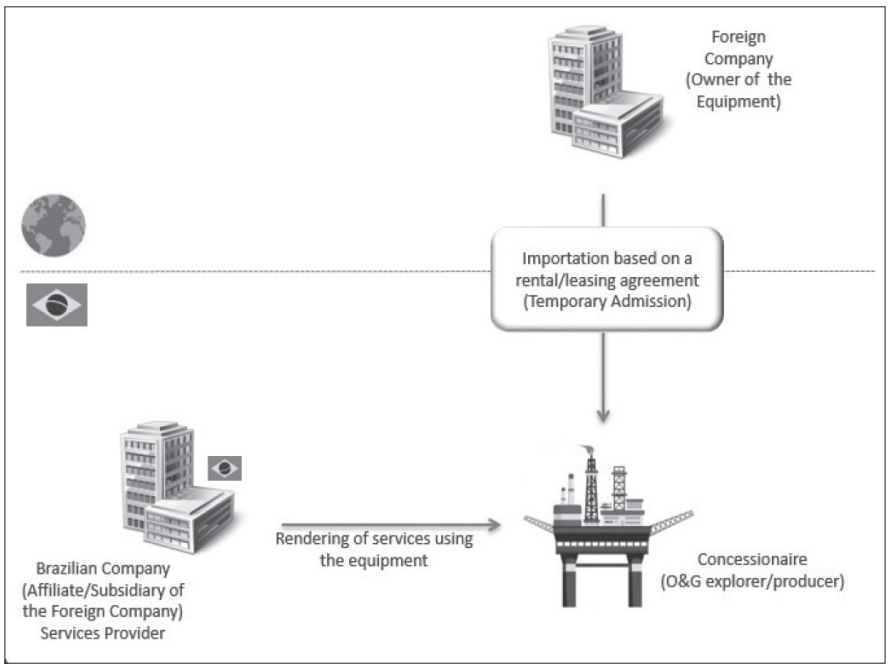
Anyway, studying the topic is important, as tax reform is a matter of futurology, and what we have today is a big litigation between the tax authorities and companies about which expenses give a right to credits, the manner and moment of accounting for these expenses in case of assets and goods acquired at pre-operational times, among other discussions.

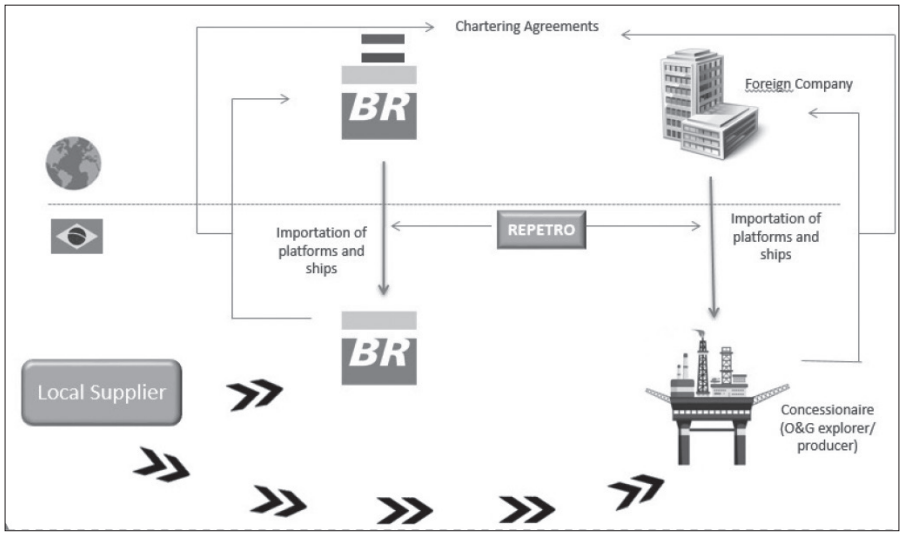
18. Structures adopted by the industry and the context of international fiscal transparency

Rafael de Moraes Amorim

18.1 Structures commonly adopted by the oil and gas industry

Over recent decades, the companies acting within the Oil and Gas industry have adopted similar structures concerning the operations carried out in Brazil, both from the corporate and the contractual point of view, considering the tax advantages granted. Basically, the most common structure would be the following:





Referring to both the import of machinery and equipment and the chartering of vessels for exploitation and production, what is usually found is the incorporation of a company in the Netherlands to be the owner of the assets, which in turn rents/charters them to the Brazilian concessionaire that will use them in the exploitation/production process.

Such structure has been providing an *optimal* taxation scenario for the companies involved, considering that, in the import process, the concessionaire company may use the benefits associated with Repetro and, at the same time, provided that some conditions are met, take advantage of the levy of the Income Tax Withheld at Source (IRRF) at the rate of 0% on the remittances for payment of amounts referring to the chartering.

In addition to that, when the remittances are taxed by the IRRF, the Treaty to Avoid Double Taxation entered into between Brazil and the Netherlands provides for a Tax Sparing mechanism, a provision according to which the Netherlands grants tax credits at a presumably higher rate than that adopted for IRRF purposes upon payment by the Brazilian company. This situation may cause a quasi-exemption of taxes in the Netherlands, in the case that this income has a beneficial treatment under the domestic law.

In this sense, in transactions of this nature, the companies involved might take advantage of a very reduced global taxation or even double non-taxation,

by virtue of the benefits of the treaty combined with the advantages set forth by the local laws.

However, in view of a context of deep changes in the international taxation environment, such structures may not be feasible anymore.

18.2 The BEPS project and its consequences for international taxation

Recently, the G20 and the Organization for Economic Co-operation and Development (OECD) have entered into an agreement to start a very audacious process, named Base Erosion and Profit Shifting (BEPS), with the purpose of limiting and even preventing countries and companies from using tools that would lead to an unequal competition within the international taxation context, be it due to the lack of transparency in the rules and structures adopted, to the undue use of benefits by companies without substance, to the allocation of profit in locations without the respective economic activity, to the exploration of breaches in the domestic laws and to the creation of models in which the application of treaties to avoid double taxation ends up resulting in a situation of double non-taxation.

During its gestation, the project was quite objected to under several arguments, such as: (i) a possible attack on the sovereignty of the States, (ii) practical difficulties for implementation, (iii) imposition of rules on developing countries by entities (such as the OECD and G20) led by developed countries, amongst others.

However, in 2013, against many expectations, the project was launched and since then various actions have been carried out. Even though subject to various obstacles, mainly with regard to the alignment of the countries regarding the basis for implementation, to the exchange and use of information and the harmonization of the legal procedures and provisions, BEPS has become a reality and companies are already obliged to observe various rules related to the Project. What also draws one's attention is the speed at which the main guidelines are being discussed and implemented: very quickly, considering the complexity of the initiative.

BEPS is based on 4 main pillars, aiming that international taxation policy measures bring justice, coherence, transparency and substance so that profits

are not artificially transferred to jurisdictions with low taxation practices. In this sense, 15 major actions supported by these main pillars were launched, which include, among other things, the prevention of the use of hybrid structures[1] that lead to double non-taxation, the abusive use of treaties, the correct allocation of profits to where values are effectively created within a context of digital economy and the creation of a multilateral instrument that provides for the harmonization of the taxation systems within the international context.

Currently, more than 110 countries[2] have committed, within the scope of the OECD/G20 Inclusive Framework on BEPS, to apply the concepts and start the processes to change the local laws as well as any treaties in order to avoid any double taxation that might cause any rules to conflict with the Project. This step is also being adopted by tax havens, which are changing their preferable tax regimes so as to be consistent with the BEPS Actions.

In addition, automatic information exchange mechanisms were created between the Tax Authorities of the adhering countries for the purposes of satisfying the pillar of transparency and, consequently, the other pillars of the Project.

18.3 Impacts of BEPS on the oil and gas industry

Within this context, starting from the assumption that BEPS is *irreversible*, the Oil and Gas Industry will certainly change or adapt the structures that were being adopted. It was not unusual that companies without substance (without employees or with an incompatible number of employees when compared to the financial transactions carried out and the assets held) were created in the Netherlands or in tax havens to acquire the assets used in the operation in Brazil and earn the profits arising therefrom with little or no taxation. It was also not unusual for companies to use the treaties to avoid double taxation so as to reduce it or eliminate it in both countries involved.

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1 Structures by which a given income may have one legal nature in one country and a different one in a second country, resulting in double non-taxation situations due to the mere diverse interpretation of each jurisdiction. An example in Brazil would be the payment of interest on equity, which could be treated as a distribution to shareholders with the nature of dividends or as a financial expense.

2 OECD/G20 Inclusive Framework on BEPS – Progress Report July 2017-June 2018.

With the advent of BEPS, this conduct is no longer sustainable, not only because it would not be acceptable anymore under a conceptual point of view of international tax justice but also because the countries involved have already been building barriers themselves for that to happen.

In this sense, as Brazil and the Netherlands are signatories to the Project (as well as several other jurisdictions that might be involved with activities affecting the Oil and Gas Industry), changes have already started being introduced to the domestic laws and Treaties to avoid double taxation. Recently, in July 2017[3], Brazil and Argentina entered into a Protocol altering several clauses of the respective treaty for the purposes of adapting it to BEPS.

It should be noted, therefore, that the countries have adopted the commitment to, among other procedures: (i) adapt their laws according to the BEPS guidelines to eliminate benefits or gaps that are harmful to a correct allocation of the tax revenues around the world (harmful tax practices); (ii) start multilateral or bilateral procedures in the sense of adapting the clauses of the Treaties to avoid the double taxation in a way that any benefits are artificially used to create situations of double non-taxation; (iii) create mechanisms to settle disputes or conflicts of interpretation by reason of the application of the treaties; (iv) adhere to a very robust information exchange system, with the active participation of banks as the intermediates of the international financial transactions.

Consequently, the creation of aggressive tax planning will be virtually impossible, unless jurisdictions that do not cooperate with BEPS are included in the structure. Anyway, this fact will draw the attention of the Tax Authorities so much that it will probably not be sustainable in the long term.

On the other hand, could it be said that there is no more space left for the Oil and Gas Industry to create tax planning within the international context? In fact, nº Within the scope of BEPS itself, there is a survey of all regimes and benefits existing in the countries, in a way that the specificities of each jurisdiction are considered. In this sense, countries with few resources, or with little industrial vocation or consumer market, may keep certain incentives provided they allow for the generation of value in the own location, do not cause

3 Available at: <http://idg.receita.fazenda.gov.br/noticias/ascom/2017/julho/brasil-e-argentina-assinam-protocolo-que-altera-o-acordo-para-evitar-a-dupla-tributacao-entre-os-paises>

distortions neither unfair competition for tax revenues and do not result from structures without substance, allocating resources in the adequate jurisdictions.

Therefore, the companies acting in this industry will need to be creative and consistent in the setting up of their structures, without them being created with the single purpose of generating tax advantages. As said before, initially there was a huge reaction to the BEPS Project, but, with the development of the actions and the perception that competition for tax revenues would occur in a fairer manner, this certainly brings benefits in a much more integrated and globalized world. In the same way that loyal competition is sought within the competitive/economic scope, a scenario in which the dispute for tax revenues is also loyal ends up being very healthy.

PART V

ISSUES INVOLVING OFFSHORE UNITS

19. Provisional attachment of vessels – Evolution of the brazilian legal system – Current vision and concerns

Erika Feitosa Chaves

19.1 Introduction

In spite of the numerous issues pertaining to Maritime Law, this article will deal with the institute of the provisional attachment[1] of vessels, as a procedural instrument to ensure the security of commercial relations, especially with regard to the satisfaction of credit.[2]

This is because, in the international trade of goods, the cases of nonperformance are increasing. National creditors, faced with the inexistence of assets, a branch or representation of the foreign debtor in Brazil, end up finding an effective solution to their problem through the constrictive measure of the provisional attachment of vessels arriving at Brazilian ports.

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1 In this article, the terms *provisional attachment*, *embargo* or *detention* of vessels shall be considered as synonyms, in the sense of restrictive measures to the navigability of vessels, except for the positioning of some jurists' opinions as to the difference between the terms. On the subject, Ruy de Mello Miller emphasized "(...) EMBARGO is limited to the nature of the debt and PROVISIONAL ATTACHMENT is not linked to the nature of the debt, but, rather, to its quality – liquidity and certainty. It is no less true, and it must be said that some jurists do not even take the understanding set out here into consideration, since they categorically assert that there is no difference between the two. Although part of the opinion of jurists does not see any difference between the two INSTITUTES, viewing them as two sides of the same coin, we dare to disagree, since, in practice, there is a resistance from the lower courts of the Judiciary to grant the apprehension or retention of the ship, when the credit presented IS NOT FIXED AND CERTAIN, even if the initial briefs are based on a PRIVILEGED credit". (*Maritime and Port Law*. Editora Comunnicar, 2011, page 21)

2 "(...) it is a true guarantee instrument – a remedy to protect – that has as its scope the effectiveness of a future execution or execution already in progress, avoiding the dilapidation of the debtor's assets in a consequent loss to its creditors." (GIBERTONI, Carla Adriana Comitre. *Theory and Practice of Maritime Law*. Editora Renovar. 3rd ed. 2014. p. 349)

19.2 Applicable legislation and its evolution

The Brazilian Commercial Code of 1850[3] was Brazil's first normative instrument, by means of which trade relations were regulated, with the clear purpose of guaranteeing greater legal security for national and international commerce, aimed at strengthening and expanding it.

It was through the aforementioned Commercial Code that the Brazilian legislature sought to regulate trade through maritime transport, which was the primary means for the flow of goods, especially at the international level (export and import), as is seen in articles 457 to 796.[4]

In this sense, the specific provision of article 480[5] of the aforementioned Commercial Document granted the possibility of apprehending or retaining vessels to satisfy the credit sought, in the situations included in

3 The Commercial Code was sanctioned and enacted through Decree nº 556, of 06.25.1850.

4 Despite the repeal of the first part of the Commercial Code of 1850 by article 2,045 of Law nº 10,406/2002 (Brazilian Civil Code), the provisions relating to maritime transport (arts. 457 to 796) remain in force.

5 "Article 480. No vessel may be *apprehended or held* for non-privileged debt; except at the port of registration; and even in this situation, only in cases in which the debtors are by right obliged to provide collateral in court, the competent actions being considered beforehand."

the exhaustive list contained in its articles. 470[6], 471[7] and 474[8]. That is, only debts directly linked to the vessel would constitute privileged credit, in order to legitimize the granting of the injunction provided for in the Commercial Code of 1850.

It should be added that article 479[9] of the aforementioned Law established additional requirements for the implementation of the restrictive measure by prohibiting the retention of vessels that (i) already had more than a quarter

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6 "Article 470. In the case of voluntary sale, the ownership of the vessel passes to the buyer with all its charges; except for the *rights of the privileged creditors* who have an implied mortgage. Such are:
1 - salaries due for services rendered to the ship, including salvage and piloting;
2 - all port rights and shipping taxes;
3 - the salaries of warehouse keepers and necessary expenses incurred in the custody of the ship, including the rent of storage depots and appliances of the same vessel;
4 - all expenses of the cost of the ship and its belongings, which have been made for its custody and conservation after the last voyage and during its stay in the port of sale;
5 - the wages of the captain, officers and crew, due on the last voyage;
6 - the principal and premium of the insurance taken out by the captain on the hull and apparatus or on freight (art. nº 651) during the last voyage, the contract being entered into and signed before the ship departs from the port where such obligations are contracted;
7 - the principal and premium of the insurance taken out on the hull and apparatus, or freight, before starting the last trip, in the cargo port (art. nº 515);
8 - the amounts lent to the master, or debts incurred by him for the repair and costing of the vessel, during the last voyage, with the respective insurance premiums, when by virtue of such loans the master has avoided signing insurance (art. nº 515);
9 - missing items in the delivery of the cargo, insurance premiums on the ship or freight, and ordinary breakdowns, and everything relating to the last trip only."

7 "Article 471. *The following are likewise privileged*, even if contracted before the last trip:
1 - debts arising from the contract for the construction of the ship and respective interest, for a period of 3 (three) years, counted from the day the construction is finished;
2 - the costs of repairing the vessel and its equipment, and respective interest, for a period of two (2) years from the day the repair is terminated."

8 "Article 474. Following the credits mentioned in articles 470 and 471, the unpaid purchase price of the ship and the respective interest, for a period of three (3) years, as of the date of the instrument of the contract, *are also privileged*; provided, however, that such credits appear in registered documents filed in the Registry of Trade in a timely manner, and their importance is noted in the records of the vessel."

9 "Article 479. For the duration of the liability of the vessel for privileged obligations, it may be apprehended and detained, at the request of creditors who present legal documentation (art. nºs 470, 471 and 474), in any port of the Empire where it is found, either *being without cargo or not having received on board more than one quarter of that corresponding to its assigned load*; however, *it will not be admissible if the vessel is found to have the necessary court orders declaring it to be unimpeded, regardless of the state of the cargo*; unless the debt comes from supplies made in the same port, and for the same trip."

(25%) of their total cargo capacity; or (ii) were already ready to set sail, a hypothesis in which the amount of cargo shipped would be irrelevant.

The limitations laid down in the Commercial Code of 1850 were primarily intended to safeguard the interests of the parties involved in maritime transport, including the interests of the shipowner/transporter. This is because the vessels are also involved with their own chain of contractual relations, and it is undeniable that the apprehension or retention of these in a specific Port would make it impossible to comply with the other contracts, causing a *cascade* of damage.

However, the provisions of the Commercial Code of 1850 have been strongly challenged by legal opinion and judicial decisions[10], on the ground that the above detailed requirements, specifically with regard to the restriction on the percentage of cargo shipped, would in practice make it impracticable to grant the provisional attachment. That is because the interested party would easily arrange for the vessel to be loaded with a quarter of its total capacity in order to prevent the granting of its provisional attachment.

The difficulty in fulfilling the legal conditions to legitimize the granting of the provisional attachment of vessels was also considered, by many, as a true violation of the principle of the right to action of the Judiciary (art. 5, item XXXV of the Federal Constitution), since, in the case of a foreign carrier/shipowner, without any other goods in Brazil, the release of the vessel would constitute the total unfeasibility of satisfaction of the creditor, which would amount to the impossibility of providing judicial protection.

Reinforcing the criticisms of the requirements of article 479 of the Commercial Code, some jurists also argued that the Brussels Convention of

10 "(...) The Court of Justice of the State of São Paulo (TJSP), in judging the motion for relief against the interlocutory appeal, removed the limiting rules of article 479 of the Commercial Code (...)"
I note, by the way, that the very validity of the legal prohibition of arrest when the ship is loaded with more than 25% (twenty-five percent) of its cargo, as defended by the applicant, has been questioned by specialized legal opinion, provisions of the Brussels Convention, internalized by Decree 351/1935, which makes no reference to any limit for the adoption of the measure. According to the lesson of GILBERTONI, Carla Adriana Comitre in *Theory and Practice of Maritime Law*, Rio de Janeiro: Renovar, 2005, p. 264:
"In addition to the document representing the credit, it is necessary that the ship or vessel subject to the arrest be without any cargo or with less than a quarter of its carrying capacity, that is, 25% of its capacity. This quota, however, is dubious, since it can become difficult to prove. Furthermore, there is no obligation in the Brussels Convention to prove such a limit or even to comply with it, thus opening the possibility of an arrest without such evidence." (MC 021042 – Rapporteur: Antonio Carlos Ferreira. Publication Date 05/28/2013)

1926[11], internalized in the Brazilian legal system by Decree nº 351/1935, did not provide for any cargo limit on the granting of the vessel's provisional attachment. And therefore, because it is a later rule, the internalization of the foreign rule in question would demonstrate the intention of the legislator to remove the limiting conditions provided for in the Commercial Code of 1850.

As an innovation, the Brazilian Civil Procedure Code of 1973 adapted the nomenclature of the institute of the apprehension/provisional attachment of the vessel to establish, in its articles 813[12] and 814[13], a so-called typical provisional remedy of provisional attachment. This procedural Document dispensed with the limitations set forth in the Commercial Code of 1850, relating to the loading of the vessel, as well as the linking of the debt to privileged credits. However, it established other legal requirements for the granting of the provisional remedy of provisional attachment, such as: (i) proof of the liquidity and certainty of the debt, and (ii) the provision of collateral in the hypotheses in which the claimant intended to obtain the

11 The Brussels Convention, applied among the Contracting Countries, including Brazil, concerns jurisdiction and enforcement of judgments in civil and commercial matters, regulating the issue of provisional attachment in article 54.

12 "Article 813. The provisional attachment is appropriate:
I - when the debtor with no permanent address tries to leave or alienate the assets he owns, or fails to pay the obligation within the stipulated period;
II - where the debtor, who is domiciled:
a) leaves or tries to leave furtively;
b) falls into bankruptcy, alienates or attempts to alienate possessions; contracts or attempts to incur extraordinary debts; puts or tries to put his property in the name of third parties; or commits any other fraudulent deception in order to thwart the execution or harm creditors;
III - when the debtor, who owns real property, tries to alienate it, to mortgage it or to give it on antichresis, without remaining with something or anything, free and unencumbered, equivalent to the debts;
IV - in all other cases specified in law."

13 "Article 814. For the granting of the provisional attachment the following are essential:
I - literal proof of fixed and certain debt;
II - documentary evidence or justification of any of the cases mentioned in the previous article.
Sole paragraph. The literal proof of the fixed and certain debt is equivalent, for the purpose of granting of provisional attachment, to the settled or unsettled judgment, pending appeal, ordering the debtor to the payment of money or services that can be converted into money."

arrest even before the opening hearing, known as that of *justification* (arts. 804[14] and 816[15], item II, of the Civil Procedure Code).

Specifically in relation to the proof of liquidity and certainty of the debt, the court precedents of the time [16] relaxed this legal requirement to admit the detention of vessels based on the legal institute of the *general power to grant provisional remedy* granted to magistrates based on article 798[17] of the Brazilian Civil Procedure Code of 1973.

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14 "Article 804. It is lawful for the judge to temporarily grant a provisional remedy, or after prior justification, without hearing the defendant, when he finds that, upon being notified, it may render it ineffective; in which case it may determine that the applicant lodge a real or fiduciary security to compensate for the damages that the defendant may come to suffer."

15 "Article 816. The judge will grant the provisional attachment independently of prior justification:
I - when required by the Union, State or Municipality, in the cases provided by law;
II - if the creditor provides collateral (art. 804)."

16 "(...) CIVIL PROCEDURE. PROVISIONAL REMEDY. CPC, ARTICLES 798 and 799. (...)
II - In this case, even though it was not a provisional attachment case, there was nothing to prevent a provisional remedy to prohibit the sale of a truck of the defendant, to ensure the effectiveness of a decision to be rendered in an action for damages filed by the widow of the victim of an accident caused by said vehicle.
III - Special appeal heard and granted." (Special Appeal nº 148,087/SP, Judge-Rapporteur Justice ANTÔNIO DE PÁDUA RIBEIRO, THIRD PANEL, judged on 08/31/2000, DJ 11/20/2000, page 288).
(...)
3. Possibility of granting of a provisional remedy of provisional attachment, taking advantage of the application for interlocutory remedy granted by the lower court, based on the Magistrate's general power to grant provisional remedies, in order to adapt the jurisdictional provision to the nature of the obligation and to guarantee the practical result of the case.
INTERLOCUTORY APPEAL DENIED PROVISIONAL REMEDY TERMINATED."
(AgRg in MC nº 16,906/RJ, Rapporteur Justice Paulo de Tarso Sanseverino, Third Panel, judged on 09/16/2010, DJe 11/23/2010)
"(...) ACTION FOR AN INNOMINATE PROVISIONAL REMEDY. *GENERAL POWER TO GRANT PROVISIONAL REMEDIES*. SPECIFIC PROCEDURE. *PROVISIONAL ATTACHMENT*. FIXED AND CERTAIN DEBT NOT CONFIGURED. (...)
It is admissible to file an action for an innominate provisional remedy, with the same effects of the provisional attachment, in view of the general power to grant provisional remedies established in article 798 of the CPC, to ensure the effectiveness of a future decision in an indemnification action proposed by the plaintiff, should it be ruled in his favor. In this case, there is an obstacle to the granting of this specific procedure – provisional attachment – because the debt is not considered fixed and certain (art. 814 of the CPC), since the other claim filed against the defendant is still being judged. Appeal granted."
(Special Appeal nº 753.788 / AL, Judge-Rapporteur Justice Felix Fischer, Third Panel, delivered on October 4, 2005, DJ November 14, 2005, p.400).

17 "Article 798. In addition to the specific provisional measures, which this Code regulates in Chapter II of this Book, the judge may determine the provisional measures that he deems appropriate, when

Considering that ships carrying cargo from or to Brazil, mostly belong to foreign companies, without representation, nor goods located in Brazil, there was a trend in the court precedents to favor the granting of provisional measures based on the abovementioned *general power to grant provisional remedies*, attributing to them the effects of the typical provisional attachment relief.

The aforementioned provisional remedy had as its main purpose to avoid frustration in the satisfaction of credit that would only become enforceable years later, with the definitive judgment of the judicial action, a time at which the vessel would very probably already be outside the reach of the Brazilian jurisdiction.

In line with the understanding described above, the new Brazilian Civil Procedure Code of 2015[18] favored the positioning of court precedents in order to definitively remove the legal requirements previously imposed by the Commercial Code of 1850, also disregarding those established by the Civil Procedure Code of 1973.

The Brazilian Civil Procedure Code of 2015 established the new procedural figure of the *urgent interlocutory relief of a precautionary nature*, which includes the provisional attachment, provided for in articles 300[19] and 301[20], whereby only the evidence for the *probability of the alleged claim* and the *danger of damage* or *risk to the useful outcome of the lawsuit* is required for it to be granted.

One perceives, from that point on, that there was a real paradigm shift, in favor of guaranteeing the provision of security (among other things, by means

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there is justifiable fear that one party, before the trial of the litigation, may cause serious harm to the right of a third party, that is difficult to redress."

18 The Civil Procedure Code of 2015 entered into force one year after its publication, that is, on 03.18.2016, in accordance with the provisions of article 1,045 of the aforementioned Procedural Code.

19 "Article 300. Interlocutory relief shall be granted when there are elements that prove the probability of the alleged claim and the risk of loss or injury to the useful outcome of the lawsuit.
Paragraph 1. In order to grant interlocutory relief, a judge may, as the case may be, demand suitable security interest or personal guarantees in order to compensate for losses that the other party may incur, with the possibility of waiving security interests if the economically disadvantaged party cannot provide them.
Paragraph 2. Interlocutory relief may be granted on a preliminary basis or upon prior justification.
Paragraph 3. Interlocutory relief of a preliminary nature shall not be granted when there is a risk of the effects of the decision being irreversible."

20 "Article 301. Interlocutory relief of a preliminary nature may be enforced by means of a provisional attachment, sequestration, attachment lien on assets, the lodging of a protest against the alienation of property and any other suitable measure to assure the right."

of the provisional attachment of vessels), thus ensuring the future payment of national creditors involved in commercial relations carried out by sea transport.

The evolution of Brazilian procedural legislation, however, did not omit the fears reflected in the primary legislation, to the extent that, despite relaxing the legal requirements for the granting of provisional attachment, it expressly stipulated in article 302[21] of the Civil Procedure Code of 2015, about the obligation to redress for material and non-pecuniary damages resulting from the enforcement of a provisional remedy (provisional attachment) that, in the end, may come to be declared wrongful arrest.

It is important to note that in recent years there has been an increasing number of provisional remedies that have been denied. The reason is largely due to the lack of documentary evidence of the privilege of the credit sought or even of the discrepancy between the almost negligible value of the credit when compared to the radical nature of the act of constriction.

The indications also show that many of the aforementioned provisional attachment/detention remedies end up being granted based on incorrect assertions of vessels about to flee, often recklessly filed by some legal adventurers.

Part of this is due, in fact, to the increased work load of the Brazilian courts. The overload of the lower court magistrates, which has already been the subject of statistical studies by our National Council of Justice[22], makes a decisive contribution to the rendering of services with a quality inferior to that desired. In the end, in summary cognizance, without much time to deeply analyze the documents that support the lawsuits filed by those claiming to be creditors,

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21 "Article 302. Independently of any redress for a procedural injury, the party is liable for any losses that the enforcement of interlocutory relief may cause the opposing party:
I - if the judgment is unfavorable to the former;
II - when relief obtained in advance on a preliminary basis does not offer the necessary means to serve summons upon the defendant within 5 (five) days;
III - when the remedy ceases to be effective in any legal hypothesis;
IV - when the judge accepts the allegation of the peremption or prescription of the plaintiff's claim.
Sole paragraph. Damages shall be liquidated in the action in which the remedy was granted, whenever possible."

22 Source of research: site of CNJ. Available at: <http://www.cnj.jus.br/programas-e-acoes/politica-nacional-de-priorizacao-do-1-grau-de-jurisdicao/dados-estatisticos-priorizacao> – "The lower courts are the most overloaded segment of the Judiciary branch and, therefore, they are the ones providing judicial services that fall short of the desired quality. Data from the Court Report in Numbers, 2015 reveal that of the 99.7 million cases filed before the Brazilian courts in 2014, 91.9 million were in the lower courts, which corresponds to 92% of the total."

and, relying on the good faith of the disputing parties, there is a tendency for magistrates to grant the provisional attachment.

19.3 Current view – Positioning of the Brazilian Courts

With the relaxing of the legal requirements to grant the provisional attachment of vessels, and the removal of objective criteria (quantity of cargo on board, linking of debts to privileged creditors, liquidity and certainty of the debt ...), the Legislator provided greater freedom to magistrates to consider the real need to carry out such restrictions according to the peculiarities of each case.

As the last procedural reform, implemented by the Civil Procedure Code of 2015, is very recent, one notes that there is still no uniformity in judgments handed down by magistrates.

As seen, there is a tendency for magistrates, in the preliminary analysis, to protect the interests of the Brazilian creditor, by granting the provisional attachment of vessels based on the absence of representation and/or assets of the foreign company in Brazil. One perceives that numerous court decisions[23] are failing to consider the damages resulting from the constrictive act, granting the provisional attachment of vessels worth millions to guarantee disputes, often involving debts of comparatively derisory amounts.

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23 "(...) The restated amount of the debt is US$ 7,588.63 (seven thousand, five hundred and eighty-eight US dollars and sixty-three US cents), the amount converted into Brazilian currency represents the amount of R$ 23,266.73 (twenty-three thousand, two hundred and sixty-six reais and seventy-three cents). It is emphasized that the vessel bears a foreign flag and belongs to a foreign company, and may at any time leave Brazilian waters (...). Under the terms of the Brazilian Commercial Code, the obligation arising from the provision of services contracted between the parties is classified as privileged, guaranteeing the plaintiff the right to retain or apprehend said vessel, for the purpose of payment of the debt. By analyzing the facts and documents contained in the records, the authorizing requirements of the inaudita altera parte preliminary injunction can be seen, since the juridical relationship and the existence of the debt remains evident, which appears to be a good case, and the danger in delay is the simple fact that the property belongs to the foreign company, whose location will remain uncertain as from the departure of the vessel from Brazil and also because there is no indication of other assets that may guarantee future collection or execution of the credit. That said, I GRANT THE PRELIMINARY INJUNCTION to determine the apprehension of the vessel [...] of a flag registered in Cyprus, owned by the 2nd defendant, with the detention of said vessel, in the area of anchorage of the Port of Macaé, until the defendants settle or present a security deposit in the amount of R$ 23,266.73 (twenty-three thousand, two hundred sixty-six reais and seventy-three cents)." (Court of Justice of the State of Rio de Janeiro – 3rd Company Court – case nº 0058281-48.2017.8.19.0001)

On the other hand, there are other decisions[24], in which not only the risk of the vessel leaving Brazilian waters is considered, but also the value of the claim formulated in court, as well as the damages resulting from the granting of the required provisional remedy, requiring the minimum evidentiary proof of the alleged debt. In such cases, the gravity of the required precautionary measure is weighed considering it as too onerous to the debtor, owner of the vessel to be arrested.

19.4 Conclusion

From the brief timely analysis of the procedural institute of the provisional attachment, it can be seen that the legal requirements for the granting of the provisional remedy of custody of vessels have been relaxed to ensure greater celerity and effectiveness in relation to obtaining a guarantee of the future payment of the credits sought.

The evolution of Brazilian legislation, up to the issuance of the rules contained in the Civil Procedure Code of 2015, conferred greater freedom and power to the magistrates for the appraisal of *interlocutory reliefs of a preventive nature*, but it should be weighed against the interests of the parties involved in each case to avoid not only the damages arising from the denial of the arrest, but also those resulting from the inverse damage[25], which emerges as a natural

24 "(...) The plaintiff asks for interlocutory relief that would prevent one of the defendants' ships from leaving the port of the city of Rio de Janeiro or, alternatively, that would prohibit the vessel from leaving the national territory, including Brazilian jurisdictional waters. In this case, the existence of a debt is alleged, resulting from the sale of airline tickets, which were not effectively paid for, with the risk that they will flee from national territory and frustrate the purposes of this action. They reinforced the claim by alleging the existence of debts with other companies, as well as a fraudulent change in its company name, with the objective of thwarting the expectations of the creditors. (...) the measure sought is to suppress the use of the property of a ship, the stoppage of which would mean expenditures that, depending on the duration, would add up to a value higher than that sought. To grant such a broad measure, a minimum of proof is required about the debt, its origin and the risk of irreparability of the damage caused. Therefore, I deny the provisional remedy, without loss of appeal, after the presentation of the defense." (Case nº 0163766-97.2017.8.06.0001, 33rd Civil Court – Court of Justice of the State of Ceará)

25 "In an even more forceful way, ARAGÃO (1990, v. 42) also warns that 'there are certain injunctions that bring worse results than those that they sought to avoid.' The non-production of the so-called *periculum in inverse moratorium*, necessarily implying the good sense of the judge, therefore undoubtedly emerges as an unshakable assumption for the final decision for the granting of the preliminary injunction – to always, and obligatorily check – since, in no circumstance, could it be

consequence of the constriction, an extremely burdensome measure and whose negative impacts may even exceed the credit whose satisfaction it is intended to guarantee for the original creditor.

understood as a licit procedure to modify a situation which is in fact potentially prejudicial for one party – but tranquil for another – for a new one which only reverses the original equation, while safeguarding the interests of one of the parties to the detriment of the other and the high cost of imposing encumbrances (hitherto non-existent and sometimes even unbearable)." (Federal App. Judge Reis Friede – R. EMERJ, Rio de Janeiro, v. 17, n. 66, p. 249-286, Sept-Dec 2014, p. 271)

20. Damage to cargo in maritime transport – Considerations about the limitation period in the light of brazilian Law

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The shipping industry undoubtedly carries with it great challenges arising from the dangers inherent to shipping itself. The ocean frequently surprises even the most experienced navigator, making the crossing unexpectedly difficult. Thus, due to so many risks on the high seas, the maritime carrier has always found itself dealing with the possibility of damage. Over the centuries many ways have been created to deal with the damage, both to the vessel itself, as well as to the cargo being transported.

The sophistication and advancement of maritime transport has meant that the institute of dealing with damage has also undergone important developments. Increasingly complex business relationships often involve different players with contracts that, for the most part, involve an isolated piece of this large chain. Therefore, the great challenge of the parties involved is to know how to proceed when an accident occurs.

One of the aspects that most concerns the parties that embark on a maritime adventure is the issue involving the limitation period of their right to complain about the damages suffered. The purpose of this doctrine, typically from civil law, is to stipulate a temporal lapse in which the holder of the right or his representative can file a complaint to the Judiciary with the objective of seeing the damage suffered duly repaired. Therefore, the Law regulates this period, from the start to the end of a legal claim, according to the seriousness and complexity of the circumstances surrounding that relationship.

In this article, we will exclusively address the doctrine of limitation period pertinent to the damage of cargo transported by sea. The aforementioned theme navigates in murky and not very calm waters in relation to Brazilian Law. Despite advances, legal opinion and court precedents have faltered a lot in the last decade, leaving the industry very apprehensive. Currently, one perceives firm guidelines in the position adopted by courts, but they still need to be consolidated in a definitive way, in order to clarify all the follow-up procedures.

But it has not always been so.

Ironically, this issue was easily dealt with when the first part of the Brazilian Commercial Code of 1850[1] (CComB) was still in force. This is because, in the aforementioned first part – *Title XVIII*, there was a section totally devoted to the limitation period in maritime transport, specifically making provision, in its article 449, 2, for the one (01) year old term for disputes involving the delivery of cargo.[2]

This rule was also extended to the Insurers who represented the rights and actions of their Insured parties (owners of the transported cargoes), through Precedent 151, of the Federal Supreme Court (STF), issued in 1963.[3]

Reinforcing the application of the one-year limitation period, the provision contained in article 8[4] of Decree-Law nº 116 of 1967[5], covering actions due to lost or missing cargo, damage to or the breakage of cargo came into force not long afterwards.

However, the first part of said CComB was completely revoked in 2002, with the advent of the current Brazilian Civil Code[6] (CCB) and, as a consequence, the abovementioned article 449 (2) was lost enforceability.

The partial repeal of the CComB, in the part dealing precisely with the statute of limitation for damage to cargo, ended up *dangerously* opening the

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1 Articles 1 to 456, of Law nº 556, dated 06.25.1850.

2 **"Article 449**. Also prescribing at the end of 1 (one) year:
2 - The legal actions for delivery of the cargo, counting from the day the trip ended."

3 Precedent 151 STF: "Legal action by the insurer subrogee for compensation for missing cargo or the loss of cargo transported by ship *is limited* in one year".

4 "**Article 8**. Actions for loss of cargo, as well as actions for missing content, reductions, damage to or breakage of the cargo *are time barred* at the end of one year, counting from the date of the unloading of the cargo from the cargo ship."

5 "It makes provisions for operations inherent to the transportation of goods by water in Brazilian ports, defining their responsibilities and dealing with missing and damaged cargo."

6 Law nº 10,406, of January 10, 2002, in its article 2,045.

doors to the interests of some segments of the maritime trade, especially that of the insurance sector, would vindicate the extension of the said limitation period. This extension originated on the application of the new general statute of limitations rule established by the CCB.

Since the insurance sector is responsible for filing almost all recourse actions resulting from claims paid to the Insured parties (cargo owners), there was clear interest in increasing the limitation period for filing to the Court, in the increase of the time limit for applying to the Court.

Although the CCB was silent regarding the statute of limitation specifically regarding the damage of cargo, it established in its article 206[7] the general statute of limitation rule of three (03) years for lawsuits based on damages requesting for compensation.

Based on the new limitation general guideline, coupled up with the argument that CComB´s specific rule on limitation would no longer be enforceable due to its partial repeal, another theory arose defending the application of the triennial limitation period for lawsuits based on damaged cargo.

But the greed of these interests did not stop there.

In parallel, another extensive legal discussion took over the Judiciary. The same trend, which defended the application of the CCB´s general limitation rule, also led, by default, to the application of an even more elastic limitation rule. The argument put forward was supported by the Brazilian Code Consumers Protection ("CDC"), sanctioned twelve years before the CCB, and when the CComB´s limitation rule was still fully enforceable.[8]

The limitation rule for reparation of damages contained in the CDC, and established through article 27[9], provided a five-year term for filing a lawsuit.

Although the CDC makes provisions relating to consumer protection, exclusively disciplining the relationships and responsibilities between the supplier of products or services with the final consumer, the fact is that several Brazilian Courts, including endorsement of decisions rendered by the Superior

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7 "Article 206. Prescribes: (…)
paragraph 3. In three years: (…)
V - the claim for civil damages;"

8 Law nº 8,078, dated September 11, 1990.

9 "Article 27. The claim for reparation for damages caused by defective product or service, provided for in Section II of this Chapter is time barred in five years, and term begins as from the knowledge of the damage and its authorship."

Court of Justice (STJ), inadvertently began to accept the five-year limitation period argument. In general, the main argument adopted by this thesis was based on the understanding that any contractual relationship involving the owner of the cargo and the maritime carrier demonstrated a relation of consumption.

At this point, real chaos came about in our legal system in terms of limitation period relating to cargo damaged during shipping.

We had the following limitations rules under discussion: the annual term contained in both Decree-Law 116/1967 and Precedent 151 of the STF; three-year period established by the new CCB and, finally, the five-year term of the CDC.

For years Brazil suffered with this issue and, consequently, with legal uncertainty. We regularly advise our clients to adopt the most cautious position in order to avoid forfeiture of the right, furthermore, we have worked long hours in the attempt to explain to clients (especially foreigners) which applicable limitation period limitation would be in their specific case.

Only now the referred discussion is finally beginning to have a concrete outcome, where the divergent court precedents of the past are coming to follow a unified direction, giving tranquility to this tortuous divergence and, most important they are finally trying to impose the so desired legal certainty.

The most recent decisions, both by the State Courts and by the Superior Court of Justice (STJ), have been analyzing this issue in more detail, repeatedly coming to the conclusion that there is no consumer relationship in the vast majority of cargo transportation contracts. This is not to say that the issue involving the transport of cargo cannot be examined in the light of the consumer code (which should be analyzed on a case-by-case basis), but the important thing is that the Courts have come to realize that they were committing a major mistake by judging, indiscriminately, all transport contracts under the aegis of the Consumer Protection Code (CDC).

Moreover, in the examination of each specific case, the current court precedents are based precisely on the legal nature of the relationships of each transport contract, making it compatible with the specific (special) legal rule that regulates the matter, in the form of article 732, of the CCB (Brazilian Civil Code)[10].

10 "Article 732. The provisions found in the special legislation and in international treaties and conventions, in general, are applicable to the transportation contracts, if they fall within them, provided they do not contradict the provisions of this Code."

And, in addressing this issue, the case-law has rejected the assumption that the CCB would have superseded the existing special legislation in force, confirming the validity and applicability of both Decree Law nº 116/1967, as well as Precedent 151/STF itself, for appeals filed by Insurance Companies, representing the rights of their Insured parties. Consequently, it has been established that the Insurance Companies are subject to the one-year statute of limitations rule.

Within this same discussion, we anticipate that the prevailing position will be that the initial term for counting the annual limitation period will begin only at the time of effective subrogation. That is, once the insurance indemnity is fully complete in favor of the Insured, through the administrative channels (internal regulatory process) or through payment in court.

Lastly, it should be pointed out, for the sake of clarity, that the CCB guarantees the interested party the right to renew the statute of limitations for a period equal to the original period. The credit holder (owner of the cargo or its Insurer) has the right to renew the initial starting point for counting limitations, but only being able to apply this extension once.[11]

The materialization of this renewal occurs through a judicial notification[12], without litigation, to be presented in Court during the period of the original statute of limitations. The procedural instrument used to do so was conventionally termed an *Protest that Interrupts the Statute of Limitations*.

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11 "Article 202. The interruption of limitations, which may only occur once, shall occur:
I - upon an order from a court, even if it lacks jurisdiction, ordering *for the lawsuit to be served*, if the interested party provides such service within the time and in the form set forth in procedural law;
II - upon protest, in the same conditions set forth in the preceding item;
III - upon protest of a negotiable instrument;
IV - upon submission of the negotiable instrument to the probate court or in composition for the benefit of creditors;
V - upon any judicial act that puts the debtor in default;
VI - upon any unambiguous act, albeit extrajudicial, that implies acknowledgement of the claim by the debtor.
Sole paragraph. Such interrupted statute of limitations resumes from the date of the act that interrupted it, or of the last act of the process that interrupted it."

12 "Article 726. Whoever has an interest in manifesting his or her will to another regarding a legally relevant matter may notify persons who participate in the same legal relationship in order to make them aware of his or her intention.
Paragraph 1. If the claim is to publicly disclose by means of a publication, the judge shall only grant it if there are grounds and if it is necessary to safeguard a right.
Paragraph 2. The provisions of this Section are applicable, where appropriate, to *judicial protest*."

We hope to have contributed to the clarification of the reasons why this issue has become one of the main themes debated by our Courts in recent years.

The controversy surrounding the limitation period applied to the Insurers, as representatives, seems to us, now, to be on a common path. Nevertheless, we need to be attentive to the discussions involving consumer relations in the transport of cargo to avoid a regression of jurisprudential precedents.

In any case, and until the subject is finally resolved, we must continue to defend the position on the prevalence of the existing special laws over those of a general nature, in accordance with the best legal hermeneutics.

21. The limits of brazilian jurisdiction to litigate and judge conflicts in the international shipping industry in the light of the civil procedure code

Flavia Melo

21.1 Introduction

Almost every Brazilian attorney who deals with offshore issues has already regretted for at not being able to assist a particular foreign client because Brazil does not have jurisdiction to consider a particular matter. The reason for this is that contrary to the countries that have a judiciary system with more attractive rules for the jurisdictional shopping market[1], our country has set up its legal system in a diametrically opposite direction. The reason behind this, primarily, due to the fact that we are a country of continental proportions and a generator of a great volume of conflicts which is growing exponentially, overwhelming the legal system. Thus, at the same time in which the legislator saw the need to make Brazilian sovereignty flexible, limiting the cases in which Brazil holds exclusive jurisdiction in certain matters, there was no interest in attracting to the judicial system legal questions without any connection with the country[2].

Although the Federal Constitution made provision, in its article 5, XXXV, that "the law will not exclude from the examination of the Judiciary harm or

1 "…seeks, within jurisdictions of competing competence to examine a certain case, the one where the plaintiff or the parties imagine that a decision more favorable to their interests might be obtained, because of the law to be applied, or as a result of procedural rules that provide greater celerity in the judgments." (JATAHY, Vera Maria Barrera. *The conflict of jurisdictions*. Rio de Janeiro: Forense, 2000, p. 283)

2 "...as the State is an organization with a practical purpose, it would not be in its interest to occupy the courts with issues that are not related to its legal system in any circumstance, such as the domicile of the parties or the location of the objective of the claim in its territory, or the occurrence in it of the facts that originated the claim, etc." (BARBI, Celso Agrícola. *Comentários ao Código de Processo Civil* (Comments on the Civil Procedure Code), vol. I. Rio de Janeiro: Forense, 2008, p. 301)

threat to the law", the legislator understood that it would be better to establish rules of jurisdiction that limit the cases in which a claim of a foreign nature might come to be filed and judged in Brazil. In this chapter we are going to address some of these circumstances, limiting ourselves to the most common cases in our routine as offshore attorneys – but without the intention of exhausting the subject, only raising some interesting points to promote critical thinking on the matter.

21.2 Limits to the brazilian jurisdiction

The limits to the Brazilian jurisdiction are provided in the Introduction to the Norms of Brazilian Law and in articles 21 through 25 of the Civil Procedure Code. These are the first regulations that the Brazilian judge must seek to determine if it is competent or not to file and judge a certain case.

For our study, which focuses on subjects of interest to the international shipping industry, the cases of competing jurisdiction are particularly interesting, that is, the circumstances in which both the Brazilian legal system, as well as a foreign legal system hold jurisdiction to file and judge an lawsuit that involves a foreigner or a foreign subject matter. These cases are specifically provided for in article 12 of the Introduction to the Norms of Brazilian Law[3], in article 21 and in article 22, items II and III, of the Civil Procedure Code.

Also, of interest to our study is article 25 of the Civil Procedure Code, which deals with the opposite case, that is, a situation in which Brazilian justice does not have jurisdiction to file and judge an action that involves a foreigner or foreign matter.

Let us proceed then to examine the circumstances described in the above-mentioned articles, always from the point of view of the interest of the international maritime community.

3 "Art. 12. The Brazilian judicial authority is competent when the defendant is domiciled in Brazil or the obligation will have to be fulfilled here." Law of Introduction to the Norms of Brazilian Law (Decree-Law nº 4,657, dated September 4, 1942). The cases are treated separately, in items III and IV of this Chapter, following the wording of the Civil Procedure Code.

21.3 Defendant domiciled in Brazil

Article 21, item I of the Civil Procedure Code sets out the conditions in which the defendant could be sued and judged by the Brazilian courts:

> "Art. 21. *The Brazilian judicial authority is competent* to file and judge actions in which:
> I – the *defendant*, whatever its nationality may be, is *domiciled in Brazil*;
> (...)
> Sole paragraph. For the purpose of the provision in item I, the foreign legal entity which has an agency, branch office or subsidiary is considered to be domiciled in Brazil." (Our emphasis.)

The first concept that deserves our comment is the concept of *domicile*, the definition of which is in the Civil Code, in its article 75, IV, paragraphs 1 and 2:

> "Art. 75. As for legal entities, the domicile is:
> (...)
> IV - the other legal entities, *the place where the respective boards of directors and management operate, or where they elect* a special domicile in the articles of organization or institution.
> § 1 The legal entity having various establishments in different places, each one of them will be considered a domicile for the acts practiced in it.
> § 2 If the management, or the board of directors, has the headquarters abroad, the legal entity shall be domiciled, with regard to the obligations contracted by each one of its agencies, the place of the establishment, site in Brazil, to which it corresponds." (Our emphasis.)

We see, therefore, that in general, Brazilian law establishes that the place in which its boards of directors and management operate, or the place in which the articles of association are established in considered to be the domicile of the company. If the company has other establishments, exercising its activities, in various places, each one of these establishments may be considered a domicile for the purpose of the acts practiced in those respective locations.

The same concept is applied to the company headquartered abroad, but with an unique and more important difference: the foreign company must have

an agency, branch office or subsidiary[4] in Brazil, according to what is taught in paragraph 2 of article 75 of the Civil Code and the sole paragraph of article 21 of the Civil Procedure Code. Then the Brazilian courts would have jurisdiction to file lawsuits based on acts practiced in the places of establishment of its agencies, branch offices or subsidiaries.

As we have seen, the definition of branch office, subsidiary and agency is linked to the concept of *establishment*, defined by article 1,142 of the Civil Code as a "complex of assets organized to carry out the business of the company, by an entrepreneur, or by a business corporation". Although jurisprudence has already defined that the nomenclature does not matter for the understanding that the agency, branch office or subsidiary are constituted as establishments for the operation of a foreign company[5]. We must pause at this point in our study on jurisdiction to highlight the confusion that the definition of agency, as provided in Brazilian law, brings to the offshore universe.

So that we might understand the issue, let us see some concepts of agency, branch office or subsidiary in the Civil Code. The concept of agency is in article 710 onwards of the Civil Code, especially mentioning article 710, as well as article 711, that respectively establish the following:

> "Art. 710. By the contracting of an *agency*, a person assumes, *on a regular basis*, and without a relationship of dependence, the obligation to promote,

4 "The secondary commercial establishments are the branch offices, subsidiaries or agencies. These terms, as a rule are employed as synonyms. But it can be understood, in a strict sense, as: a) subsidiary, the secondary establishment subordinate to the main one, for it was created to expand its business, for this reason, its manager, despite enjoying some autonomy and self-organization, should follow the guidelines or instructions given by the head office about the most important business; b) branch office, the secondary establishment linked to the head office and on which it depends, with power to represent it, under the direction of a representative who practices economic activity within the instructions given; so, this manager doesn't just have any autonomy, and is totally subject to the centralized management of the head office. There exists, in the branch office, a total legal and economic subordination to the main establishment; and c) agency would be the secondary establishment that represents the main one to perform business activities in another location." (DINIZ, Maria Helena. *Curso de direito civil brasileiro* (Brazilian Civil Law Course), volume 8: Company Law 2nd Revised edition. São Paulo: Saraiva, 2009, p. 780-781)

5 "Agency, branch office or subsidiary (CC 75 § 2). When the law speaks of an agency, branch office or subsidiary, it is referring to the existence of an establishment of a foreign legal entity in Brazil, whatever the name given to this establishment (RT 596/117)." (I. NERY JUNIOR, Nelson. II NERY, Rosa Maria de Andrade. *Comentários ao Código de Processo Civil* (Comments on the Civil Procedure Code). São Paulo: Editora Revista dos Tribunais, 205, p. 275)

> on behalf of a third party, through remuneration, the performance of certain business, in a determined zone, distribution being characterized when the agent has the item to be negotiated at its disposal.
> (...)
> Art. 711. Without agreement, the proponent cannot constitute, at the same time, more than one agency, in the same zone, with an identical encumbrance; *neither can the agent assume the responsibility through it of business of the same type, at the account of other proponents*." (Our emphasis.)

We see, therefore, that in the contracting of an agency, the agent is appointed by the foreign proponent to carry out business on a regular basis, and cannot be nominated to perform the same service for third parties.

Transferring these concepts to maritime law, it becomes clear that a shipping agent[6], for example, does not practice the activities of the agency contract as described in the Civil Code. To the contrary, the shipping agent works under the orders of various shipowners[7] and in an absolute occasional manner[8], which might be, only when the ships of their contracting parties dock in Brazilian waters. However, the coincidence of the nomenclatures usually causes confusion, making the users of Brazilian law not used to the maritime practices understand them as those described in the Civil Code for the agency contract.

Having made this small observation, we conclude that, under the terms of item I of article 21 of the Civil Procedure Code, only the foreign company

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6 "As an aid in preparation are the services rendered to the ship, without having a direct relationship with the commercial function of the vessel, such as: assistance in the clearance of the ship and government offices; embarkation and disembarkation of crew-members; payments; rendering of services relating to port social security or health services; transport to ships anchored offshore; requisition of pilots; riggers; mooring; plane or bus tickets for crew-members that disembark; arrangements with suppliers; laundries, etc. As assistant to maritime transport it assumes the function of contracting cargo transportation, as well as the operations for handling it; besides the re-clearance of merchandise, that is, the clearance of merchandise in transit after the unloading of the ship." (I. ANJOS, J. Haroldo dos. II. GOMES, Carlos Rubens Caminha. *Curso de direito marítimo* (Maritime Law Course), Rio de Janeiro: Renovar, 1992, p. 69)

7 "The shipping agent may represent the proprietor of the vessel, the shipowner, the administrator or the charterer, the carrier or some of these simultaneously." (OCTAVIANO MARTINS, Eliane Maria. *Curso de direito marítimo* (Maritime Law Course), volume I: general theory. 4th Ed. Barueri: Manole, 2013, p. 324)

8 "The agent acts up to where its actions do not put it in the place of the client. It is not a representative, not even, a proxy. On the other hand, its stability separates it from the mandate, which corresponds, as a rule, to occasional services." (MIRANDA, Pontes de. *Tratado de direito privado* (Treatise on Private Law). Campinas: Bookseller, 2006. Special Part, Tomo XLIV, p. 66)

that has an establishment in Brazil, whether this establishment is an agency, branch office or subsidiary, not confusing their activities with the activities of the shipping agent, a mere agent, can be a defendant before Brazilian courts[9].

21.4 Obligation to be fulfilled, a fact occurring or an act practiced in Brazil

We then see the cases described in items II and III of article 21 of the Civil Procedure Code:

> "Art. 21. *The Brazilian judicial authority is competent* to file and judge actions in which:
> (...)
> II – the obligation has to be fulfilled in Brazil;
> III – the *grounds* are a *fact* that occurred or *act* practiced *in Brazil*." (Our emphasis.)

We see that the Brazilian courts, obviously, have jurisdiction to file and judge an action involving an obligation to be fulfilled in Brazil. Applying the provision of the above-mentioned item II to the activities performed by the maritime community, we see as an example a charter agreement for the transport of cargo to be shipped in Brazil, the destination of which is a foreign port. The parties to the contract can be foreigners, and the contract could have been made outside of Brazil, but given the shipping of the cargo in Brazilian waters, in principle the Brazilian courts would have jurisdiction to file and judge a lawsuit to ensure the fulfillment of the obligation of shipping cargo in Brazil – even though there are doubts about the competence of the Brazilian judicial system to examine the other obligations of the contract[10]. It is important to note that, in this case, the place where the obligation was contracted does not

9 "The concept of shipping agent – or authorized broker – is usually embodied in the contractual figure of the mandate." (OCTAVIANO MARTINS, Eliane Maria. *Op. cit.*)

10 "The place of the fulfillment of the obligation is a special jurisdiction in the agreements. Does the application for indemnity for default of the contract follow this rule? I do not believe so, for it only applies to the request for the fulfillment of the obligation, and not its conversion into loss and damages, in the cases of non-fulfillment." (GRECO, Leonardo. *Instituições de processo civil* (Institutions of civil procedure), volume I. Rio de Janeiro: Forense, 2009, p. 157)

matter, but rather the fact that the performance of the obligation takes place in Brazil[11], in compliance with the principle of effectiveness[12].

Similarly, under the terms of items III of article 21 of the Civil Procedure Code, when the lawsuit is based on a fact occurring or practiced in Brazil, attention must be paid to the same principle of effectiveness. Within the shipping industry, in dealing with a fact occurring in Brazil, we can exemplify by means of an accident involving a foreign crew-member of a foreign vessel that operates in Brazilian waters; or, in dealing with an act practiced in Brazil, we have a case of an action for reimbursement for losses and damages caused by the mistaken embargo of a foreign vessel.

21.5 Consumer resident or domiciled in Brazil

A new hypothesis of attraction of the Brazilian jurisdiction was brought into effect at the time of the enactment of the new Civil Procedure Code, by means of item II of article 22. The referred to provision considers the actions that involve consumer material, in the cases in which the consumer has a domicile or residence in Brazil:

> "Art. 22. *The Brazilian judicial authority* also has *competence* to file and judge the actions:
> (...)
> II - resulting from consumer relations, *when the consumer has a domicile or residence in Brazil*;" (Our emphasis.)

On this, we must clarify that the Consumer Defense Code defines in its article 2 that: "A consumer is every individual or legal entity that acquires or uses a product or service as the end-user". This means that the companies that acquire inputs or that contract services as a part of their productive chain do not qualify as consumers.

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11 BARBI, Celso Agrícola. *Op.cit.*)

12 "When determining the applicable law, the court must bear in mind the enforceability of the decision based on this law. In other words: there would not have occurred an appropriate determination if the judgment produces an unenforceable result where it normally must be carried out." (DOLINGER, Jacob. *Private International Law*)

There also exists a subjective element in the consumer relationship which is hypo-sufficiency[13], one of the pillars of consumer protection. Hypo-sufficiency is evident in the vulnerability of the consumer and his inability to understand the peculiarities of the business to contract the acquisition of the product or the rendering of a service in equality of conditions with the supplier.

Applying the concepts described to the shipping industry, we perceive, that paragraph 2 of article 22 of the Civil Procedure Code was created to attract certain cases to the Brazilian jurisdiction so as to protect the consumer resident and domiciled in Brazil. Classic examples are the passenger of a cruise ship, the expat who contracts a shipping company to make an international move, or even a company that extra-ordinarily contracts sea freight of a certain item of imported equipment. In all the examples, hypo-sufficiency of the party is perceived as a basis for attracting the case to the Brazilian jurisdiction.

21.6 Election of jurisdiction in an international contract

Another novelty greatly celebrated by lawyers that work in the international area was the insertion of article 25 in the Civil Procedure Code, which made it possible to distance the Brazilian jurisdiction in the election of jurisdiction clause established in an international contract[14]. Let us see: "Art. 25. The Brazilian judicial authority is not competent to file and

13 "...It is evident that the consumer is, likewise, hypo-sufficient to contract. He does not have technical knowledge that allows him to understand the content of the contractual clauses. All the more so taking into consideration that the contracts are typical of adhesion to the clauses of which are unilaterally imposed by the supplier (or they are other forms of contracting – as we will see later on – by content to which the consumer does not have access). It is for this reason that, in the interpretation of the contracts, one has to consider the vulnerability and hypo-sufficiency of the consumer." (RIZZATTO NUNES, Luis Antônio. *Comments on the Consumer Defense Code*. 4th ed. Ver. São Paulo: Saraiva, 2009, p. 556)

14 "The international character of a contract can be defined in quite a variety of ways. The solutions adopted both by the national as well as international legislation vary from references to the place of the commercial establishment or habitual residence of the parties in different countries, to the adoption of more general criteria, such as having 'significant connection with more than one Nation-State', 'involving a choice between laws of different Nation-States' or 'affecting the interests of international commerce'.
The Principles do not specifically establish any of these criteria. The presumption, however, is that the concept of 'international' contracts must be given to the broadest interpretation possible, so as to exclude, in an ultimate analysis, only that situation in which some international element is involved, i.e., in which all the relevant elements of the contract are connected to just only country." (VILLELA, João Baptista *et al*. *Unidroit* (International Institute for the Unification of Private Law)

judge the action when there is an exclusive foreign jurisdiction clause in an international contract" (our emphasis).

The majority of the documents used in the shipping industry – from vessel construction and charter contracts to knowledge of transport – possess foreign jurisdiction clauses which, very often, have not been respected by the Brazilian judicial authorities[15]. Article 25 innovated in this sense, finally placing Brazil in a situation of parity with the rest of the world, having as a basis the principle of the autonomy of the will of the parties.

In this respect, we ought to explain that, so that the choice of jurisdiction may be accepted to exempt Brazilian jurisdiction, it is necessary for the clause be expressed in the contract, establishing the jurisdiction chosen as exclusive[16], that is, the only one competent to file and judge the conflicts arising from that contract.

In addition, paragraph 2[17] of the same article 25 refers to the provisions of article 63 and paragraphs[18], also of the Civil Procedure Code, which deals with the jurisdiction clause in national contracts. With this, one notes that

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principles relating to international commercial contracts/2004 [Portuguese language version]. São Paulo: Quartier Latin, 2009, p. 2)

15 "In Brazil, despite the theme having been addresses by jurists and in jurisprudence, up to the enactment of the New Civil Procedure Code the absence of a specific norm led to legal uncertainty and insecurity. Now, with the inclusion of specific permission to the election of jurisdiction clause in the CPC, the situation changes completely. The international contracts with this clause will enjoy the same legal security enjoyed by the contracts that opted for international arbitration, in which this choice was already fully accepted." (ARAUJO, Nadia de. *Direito internacional privado: Teoria e prática brasileira* (Private International Law: Brazilian Theory and Practice). 7. ed. rev. atual. e ampl. São Paulo: Editora Revista dos Tribunais, 2018. p. 179)

16 "(...) So that the clause may be valid, it is necessary that the agreement be expressed and also state that it is an exclusive clause. This avoids the interpretation of the clause as a mere obligation to do and agrees with the practices of the common law countries in which the absence of specific determination that the clause have an exclusive nature implies the possibility that the parties may appeal to the Judiciary Branch different from that chosen. The Hague Choice of Court Convention contains a provision in this sense." (ARAUJO, Nadia de. Ibid. p. 187)

17 "§ 2 Aplies to the case of the head provision of art. 63, §§ 1 to 4."

18 "Art. 63. The parties may modify the competence because of the amount and the territory, electing a jurisdiction where the an action arising from rights and obligations will be proposed. § 1 The election of jurisdiction is only effective when it appears in the written instrument and specifically alludes to a specific legal business. § 2 The contractual jurisdiction obligates the heirs and successors of the parties. § 3 Before the notification, the choice of jurisdiction clause, if abusive, can be determined as ineffective by the judge, who will determine the sending of the records to the court of the jurisdiction of the domicile of the defendant. § 4 Once notified, the defendant must allege the abusiveness of the

Brazilian law gave isonomic treatment to the contracts that establish a choice of jurisdiction for filing and judging conflicts, whether international or national.

Among the provision of article 63 of the Civil Procedure Code that may be applicable to the maritime matters, there are two that are especially relevant, set out in paragraphs 3 and 4, which deserve to be commented.

Under the terms of paragraph 3, before the parties are notified, the choice of jurisdiction will be examined and may be considered abusive by the judge, who will send the action to the jurisdiction of domicile of the defendant. The condition of abusiveness of the jurisdiction clause is closely related to the concept of hypo-sufficiency[19]. Adhesion contracts or other types of contract that presuppose little negotiation, such as the conditions of transportation appearing in maritime bills of ladings, can lead the judge to view the election of jurisdiction clause as abusive, always taking into consideration the relationship between the contracting parties and the possible technical vulnerability of one of them. In the same sense, paragraph 4 makes provision that the defendant, when notified, must allege any abusiveness of the election of jurisdiction clause in his defense, under penalty of preclusion.

As we are discussing election of jurisdiction, we take the opportunity to make a reference to arbitration clause. The possibility that parties may submit the settlement of their disputes to arbitration is provided in article 3[20] of the Arbitration Law, and is also a very common choice of the players in the international shipping market. The same logic established for the election of jurisdiction clause was also established for the arbitration clause, which must be alleged by the interested party at the first opportunity[21], *should it come to be demanded before the Brazilian justice system.*

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choice of jurisdiction clause under protest, under penalty of preclusion." (Civil Procedure Code, Law nº 13,105, dated March 16, 2015)

19 See item V, above, where we deal with the issues of Brazilian jurisdiction relating to the consumer domiciled in Brazil.

20 "Art. 3 The interested parties can submit to the solution to their litigations to the court of arbitration through an arbitration agreement, understood as the commitment clause and the commitment to arbitration." (Arbitration Law, Law nº 9,307, dated September 23, 1996)

21 "Art. 337. It is incumbent upon the defendant, before discussing the merits, to allege: (...) II - absolute and relative lack of jurisdiction; (...) X - arbitration agreement;" c/c "Art. 485. The judge will resolve the merits when: (...) VII - he accepts the claim of existence of an arbitration agreement or when the court of arbitration recognizes its competence;" (Civil Procedure Code, Law nº 13,105, dated March 16, 2015)

21.7 Submission to brazilian jurisdiction

Let us leave until last our comments on item III, of article 22 of the Civil Procedure Code, because it contains a provision of the utmost importance, which can invalidate the effects of the provision on the election of jurisdiction brought by article 25. It is the case of voluntary submission to the Brazilian judicial authorities, which can be given in a tacit or specific way[22], *in verbis*:

> "Art. 22. The Brazilian judicial authority also has competence to file and judge the actions
> (...)
> III - in which the *parties*, specifically or tacitly, *submit themselves to Brazilian jurisdiction*." (Our emphasis.)

We see that the provision allows the parties that, specifically, decline their previous choices in relation to the choice of jurisdiction, submitting and limiting themselves to Brazilian jurisdiction, in a case that would be of a competing jurisdiction, in respect to the principles of the autonomy of will and of effectiveness.

The submission to the national jurisdiction mentioned by item III of article 22 of the Civil Procedure Code can occur tacitly through the simple absence of a claim to the existence of an election of jurisdiction clause by the deadline for filing a reply, generating the preclusion[23] of the material, as we see in item VI above.

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22 "The submission of the defendant to the Brazilian jurisdiction can occur both tacitly as well as specifically. Tacit submission happens, for example, when the defendant, in an action filed in Brazil, disputes the action without claiming the lack of jurisdiction of the Brazilian courts. Specific submission occurs when, besides disputing without alleging lack of jurisdiction, the defendant files a counterclaim, characterizing with this, the 'extension of competence by voluntary submission of the parties'." (GASPARETTI, Marco Vanin. *International Jurisdiction*. São Paulo. Saraiva, 2011, p. 556)

23 "The institute of the election of jurisdiction, and its distinction from the jurisdiction of the contract, has a similar construction in other countries, among which it is possible to register, for exemplification purposes, Italy, in the lesson of Chiovenda: 'Forum prorogatum can exist when it is relative. It is that which can be established by two means: either by specific agreement, or by the fact of the election of the domicile (...). When, finally, the one who is a defendant before a court, whose lack of relative jurisdiction can exempt, does not exempt, it is produced, however, by way of the preclusion of the exemption of the lack of jurisdiction (...) the effect of the extension (...)'". (CHIOVENDA, Giuseppe. *Instituições de direito processual civil* (Institutions of civil procedural law). 3. ed. São Paulo: Saraiva, 1969. vol. II, p. 213. *apud* DE NARDI, Marcel. *Contratos internacionais* (International Contracts: Uma

In the same way, the absence of an allegation of the existence of an arbitration agreement by the party when it responds to a judicial claim can be interpreted as acceptance of the Brazilian jurisdiction and waiver to the arbitration court, as provided in paragraph 6[24] of article 337 of the Civil Procedure Code.

visão brasileira. Election of Jurisdiction in an International Contract. *In*: RODAS, João Grandino (coord.). *Contratos internacionais* (International Contracts). RT, 2002. pp. 142/143)

24 "§ 6 the absence of an allegation of the existence of an arbitration agreement, in the form provided in this Chapter, implies acceptance if the state jurisdiction and the waiver of the court of arbitration."

22. Brief notes about the responsibility of ocean freight container carriers

Bernardo Mendes Vianna

22.1 Preliminary general considerations

According to the Brazilian legal system, the general rules applicable to transport are provided by the Brazilian Civil Code[1], more precisely in its Chapter XIV, which covers articles 730 through 756. Such articles contain sections addressing general provisions, the transport of people and transport of goods.

From the examination of the referred to legal provisions, one learns that the transport contract is characterized as a contract of results[2], making the carrier liable for carrying the goods safely to the destination, under penalty of civil liability. It is what jurists have consecrated as strict liability of the carrier.

We have lived for a long time with repeated judicial decisions subjecting the carriers to civil and strict liability to compensate for losses resulting from damage occurring during the shipping.

In general terms, the main legal analysis made by the Judiciary Branch at the time of the rendering of such decisions, resides in the mere application of the referred to *theory of strict liability*, by means of which it is sufficient to prove the occurrence of the damage and the causation, that is, a link of such with the behaviour of the carrier.

Due to it being an obligation involving results, the great majority of the court orders end up imputing an indiscriminate obligation to pay compensation upon the ocean freight carrier, without even examining the reasons why the damages would have occurred. The examination of the proof, therefore, is quite simple.

1 Law nº 10,406 dated January 10, 2002.

2 "Article 749. The carrier will take the goods to their destination, taking all the precautions necessary to keep them in a good state and deliver them within the agreed to or expected time limit."

Having verified that the damage took place during the shipping, the carrier will be obligated to compensate the owner of the damaged goods or its representative.

Rarely does the Judiciary effectively focus on understanding the background of the shipping logistics, or even the procedures previously used so that the freight might arrive at the Terminal where it will, in turn, be loaded onto the freight carrier. This lack of interest, or even of knowledge, about the operational reality becomes even more evident when considering ocean freight transport in containers.

22.2 The necessary understanding about the logistics prior to the shipping

In the great majority of the cases involving ocean freight transport in containers, the carrier receives them for loading duly sealed. Likewise, the cargo transported inside these containers almost always arrives previously packed and loaded by the shipper (exporter or its representative abroad). In other words, the ocean carrier has no knowledge of or any interference in the procedures prior to the loading of the container onto the ship.

In practical terms, the container is delivered empty to the shipper and it is up to it to pack the cargo and put it into the container to be transported. At the end of this operation, and by determination of the customs legislation, the container is duly sealed to be later delivered to the carrier at the indicated port terminals.

The proof of this operation prior to loading, which takes place, as seen, without the interference of the carrier, is corroborated by the Bill of Lading itself when it refers to the mode of shipping by the abbreviation FCL (*Full Container Load*), with information entered according to the declaration of the shipper. Likewise, it operates with the caveat regarding the characteristics of the loaded cargo, denominated *Said to Contain*, where the carrier declares that it is not able to testify whether the loaded cargo combines precisely with the description on the bill of lading, for purposes of protecting itself in the future[3].

Such aspects make all the difference at the time of analyzing the concrete case and, above all, in the application of possible civil liability upon the maritime carrier.

3 "Said to Contain (STC) is a phrase used by the shipping company in the Bill of Lading when describing the goods loaded onboard a sea-going vessel in sealed containers or trailers and for which the shipping company makes the necessary reservations in terms of the correct contents of those loading units." (*In: Logistics Glossary*) Available at: <https://www.logisticsglossary.com/term/said-to-contain/>

In the Brazilian legal system, even when the theory of strict liability is applied to the concrete case, one cannot forget to verify the presence of the causation. The occurrence of the damage must be linked to actual and justified behaviour by the carrier[4]. If the damage suffered by the cargo is not related to the act of the carrier, there does not exist a causal relation.

What is perceived is that court orders have very often put to one side such important details, when it is precisely at this moment that knowledge and analysis of the operational and factual reality of maritime transportation become relevant and can make all the difference in the judgment of the concrete case.

Transport by sea results in a series of navigation movements that are inherent and normal to the modal itself. It is the responsibility of the shipper to ensure that it has taken all necessary measures to ensure that the packaging of the cargo inside the container is adequate and able to withstand the adversities, movements and unforeseen consequences of the sea-voyage itself.

In practice, we know that much of the damage occurs due to the failure to observe the abovementioned precepts. The cargo cannot move freely inside the container, otherwise it could not only be damaged, but, also, cause damage to the container itself or to other cargo stored inside it.

If the sea-voyage transpires normally, and even so, the cargo arrives damaged at its destination, it is imperative that a detailed investigation be carried out to ascertain whether a failure in the packaging of the cargo or its accommodation was not the real cause of the incident.

22.3 The recess of the cargo by the carrier from the practical-legal point of view

As already said, the containers are received by the sea-going carrier duly sealed and these seals cannot be violated by the carrier. It is also a legal imposition,

4 "The concept of causation, etymological nexus or causal relation derives from natural laws. It is the bond that unites the agent's conduct to damage. It is by means of the causal relation that we come to the conclusion about who was the tortfeasor. It is an essential element. Strict liability dispenses with blame, but will never dispense the causality. If the victim, who suffered damage, does not identify the causality which leads to the damaging act to the one responsible, there is no way to be reimbursed." (VENOSA, Sílvio de Salvo, 2003, pág. 39)

given in our Customs Regulations[5], the non-fulfillment of which implies fiscal liability for the carrier. As the seals cannot be violated, it is impossible for the carrier to verify whether the cargo has been loaded properly. And even it could hypothetically break them, the carrier would not have technical knowledge enabling it to assess this aspect.

The carrier loads and unloads thousands of containers during a journey. Therefore, it is not possible to attribute to the carrier the burden of inspecting each one of the containers and certifying that the cargo they contain was properly packed and/or stored. This would render all the dynamism of the international maritime trade unfeasible, creating insurmountable obstacles to the very logistics of such transport.

The carrier must rely on the information provided based on the declaration issued by the shipper itself. The bill of lading that accompanies the cargo is accepted by the carrier based on the good-faith and trust that it deposits in the information provided by the shipper. This is because the shipper is the only one who knows how its merchandise is going to behave when put to the test of the swells and stresses during the sea crossing. This risk, despite claims to the contrary, could never be transferred to the realm of responsibility of the carrier.

Precisely on the basis of the abovementioned operational issues, we cannot agree with those who adhere to the pure and simple application of strict liability without analyzing the entire context of the pre-shipment chain of logistics. In the same way, the legal provisions that allow the carrier to refuse cargo are ineffective[6], since, when combined with the operational reality, and, uses and customs of the shipping industry, they end up losing their purpose.

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5 "Article 333. After the verification, inspection precautions may be adopted to prevent the violation of the volumes, containers and, if applicable, the transport vehicle, in the form established by the Federal Revenue Service of Brazil (Decree-Law nº 37, de 1966, article 74, § 2).
§ 1 Inspection precautions include:
I - applying seals and other security devices; and
II - fiscal monitoring, which will only be applied in special cases.
§ 2 The security devices can only be violated or suppressed in the presence of inspectors, except for a normative provision to the contrary."

6 "Article 746. The carrier can refuse the item whose packaging is inadequate and may put peoples' health at risk or damage the vehicle and other assets." (Brazilian Civil Code)
"Art. 9. The emission of the Multimodal Bill of Lading and the receipt of cargo by the Multimodal Transport Operator turns the multimodal transport contract effective.
§ 1 The Multimodal Transport Operator, upon receiving the cargo, shall note caveats on the Bill of Lading if:

22.4 Some additional legal aspects

In favor of the carrier's exemption from liability, there is a legal provision in Decree-Law 116/1967[7], which equates the cases of inadequate packing/packaging to the inherent defect of containerized cargo. This provision, contained in paragraph 4, of article 4[8], states that the carrier must not respond for improper packaging when carried out by the shipper.

In fact, this release from liability of the carrier, within this same pre-shipment scenario, is not something new. This issue was the object of a specific legal provision in 1998, when the aforementioned Law dealing with Multimodal Transport was published[9].

Considering that the claims for damages are, in their majority, represented by the Insurance Companies, as assignees of the cargo owners, it is important that an additional analysis is made involving the legislation applicable to the insurance market. Let us take as an example the legal provision contained in the Brazilian Commercial Code, referring to the reciprocal obligations of the insurer and insured, specifically establishing that the Insurer shall not respond when the damage occurs due to the inadequate packing of the insured cargo[10].

I - it deems the description of the cargo given by the shipper inaccurate;
II - the cargo or its packaging are not in perfect physical conditions, according to the specific requirements of the transportation to be performed." (Law nº 9,611/1998, dealing with Multimodal Transport of Cargo)

7 "Makes provisions for operations inherent to the transportation of goods by water in Brazilian ports, defining their responsibilities and referring to missing and damaged cargo."

8 "Article 4 The merchandise will be delivered to the ship or transport vessel in exchange for a receipt given by the shipowner or its representative. (…)
§ 4 The inadequacy of the packaging, in accordance with official uses, customs and recommendations, is comparable to the defects of the goods, and the carrier shall not respond for the risks and consequences thereof."

9 "Article 16. The Multimodal Transport Operator and its subcontractors will only be released from their responsibility due to:
I - an act or fact attributable to the shipper or to the recipient of the cargo;
II - inadequacy of the packaging, when attributable to the shipper of the cargo;
III - inherent or hidden defect of the cargo;
IV - handling, loading, stowage or unloading carried out directly by the shipper, recipient or consignee of the cargo, or, further, by its agents or representatives;
V - force majeure or acts of God."

10 "Article 711. The insurer shall not respond for damage or breakages that occur at the fault of the insured, or by any of the following causes: (…)

To the consideration above, it must be added that the Brasilian insurance market's regulating agency (Superintendência de Seguros Privados – Susep) (Federal Insurance Commissioner) considers the case of inadequate packaging as being one of the exemptions from insurance cover[11].

All this must be considered in the defense carrier's interests, since the Insurer, in regressing against the carrier for the losses incurred by its Insured, is in fact transgressing not only the applicable legal norm, but that of an administrative order that it itself published, in true contradiction.

Finally, it is worth mentioning that in the contractual sphere, the provision of exemption from liability of the carrier contained on the back of the bill of lading stands out. The discussion surrounding the clause is well known, but this does not necessarily mean that the clause is considered to be abusive in itself. The effectiveness of this clause, when analyzed and interpreted jointly with all the operational and logistical scenario previously described, appears to be plausible to us.

22.5 Understanding the legal idiosyncrasy

The case-law decisions are still hesitant, with a strong tendency towards the uncompromising application of the theory of strict civil liability against the maritime carrier.

In the dispute over the absence of liability of the maritime carrier due to the rupture of the causal nexus, there has always been a more favorable tendency toward the reimbursement of the one who suffered the damage. In practice, it always seemed easier to condemn the carrier so that the latter, then, might seek compensation directly and autonomously against the shipper.

The initial tendency of the judges was always to reject the arguments involving the necessity to discuss causation, considering that the obligation of result of the maritime carrier (strict liability) imposed such an outcome.

Even though timid, what we currently observe is a change in the position of our Courts, especially in those jurisdictions where the busiest ports are located and, therefore, where magistrates are involved with such discussions with

6 - error in stowage, or defective organization of the cargo; (…)
10 - inherent defect, poor quality or inadequate packaging of the insured object;"

11 Susep Circular Letter 354/2007.

greater frequency. We have noticed that favorable precedents are emerging, shifting the burden of repairing the damage to the shipper.

On the other hand, the fact is that we continue to face unfavorable court decisions. The main argument still lies in the erroneous legal provision that the carrier can refuse the cargo and/or the lack a caveat on the bill of lading. Furthermore, many of these decisions argue that the carrier would be obliged to carry out an inspection (or even participate) during the packaging and packing stage as if such a practice were possible in international trade.

22.6 Final thoughts

In cases involving damage occurring during the transport by sea of cargo in containers, especially in cases related to inadequate stowage of the cargo, the lawyer should pursue the lack of causation, thus exempting the carrier from liability.

As we have seen, the risk in question is not inherent to maritime transport because it is pre-shipment, with neither the carrier nor the Insurer being liable, and the latter should not even indemnify the Insured.

In favor of the carrier we have, in addition, legal and contractual provisions holding the shipper liable, as well as relevant grounds of a practical and operational nature.

It should be pointed out that, the packing process must be analyzed, in case there is the need to establish whether liability originated before shipment. Hence, the carrier must keep all necessary documentation, and file it during the lawsuit´s evidence phase. Lastly, it is very recommendable that the carrier is able to seek advice for future court orders, aiming to take advantage of the current swing in case-law..

PART VI

RESOLUTION OF CONTROVERSIES IN THE OIL INDUSTRY

23. Mediation in the oil and gas sector

Pedro Hermeto
Luíza Latini Cunha

23.1 Basic concepts and the appeal of mediation

Mediation can be defined as a conflict resolution procedure whereby the parties, assisted by a neutral and impartial third party, jointly and voluntarily define the solution to their conflict. It can occur both in a judicial, as well as an extrajudicial setting. We will focus here on extrajudicial mediation, relevant to our subject.

The notion of party autonomy is intrinsic to the concept of mediation, inasmuch as the purpose of such a procedure is precisely to create favorable conditions for the parties to reach a consensual solution to their dispute.

Usually, mediation follows the friendly attempt of the parties to settle the conflict directly between them, through simple negotiation. As it is no longer possible for the parties, for whatever reason, to establish a harmonious dialogue between themselves, mediation is sought. Seeing their negotiations interrupted and unfeasible, the parties decide to have an intermediary, chosen or accepted by them, who will conduct the negotiations. This interposed person – the mediator – may be a lawyer or not and will perform the technical activity of facilitator of the conversation, helping and encouraging the parties to identify or develop consensual solutions to the controversy.

The mediator has no decision-making power. There will be no solution imposed, unlike what happens in the arbitration procedure or in the judicial process, in which a third party decides the case. It is, therefore, a genuine self-composition procedure, in which the parties maintain full control over the contours and scope of the final solution (a win-win situation).

This feature is one of the main advantages of mediation. Because it is a procedure in which the parties themselves construct the agreement that they must comply with, it is undoubtedly more effective than that procedure which

culminates in a judicial or arbitral decision, the content of which is imposed upon the parties.

From another point of view, which is just as relevant, the party autonomy not only makes the solution to the dispute more effective – insofar as the litigants are certainly more likely to comply with the solution proposed by them – as it tends to preserve the pre-existing, personal or commercial relationships, between the parties.

Since the judicial and arbitration proceedings are an adversarial procedure – in which the litigants use an accusatory spirit in order to convince the judge of the certainty of their right and their concrete claims –, there remains the notion, to a certain extent Manichaean, of winner and loser (a win-lose situation). The process, therefore, almost invariably leads to a deterioration of the pre-existing relationship between the litigants, making it impossible to maintain a contract of successive or long-term dealings.

The autonomy of the parties to resolve their conflicts, without resorting to the imposition of the Judiciary or Court of Arbitration, allows them not only to have a direct influence on the solution of the dispute, but also to have a broad control over the procedure, which is not subjected to the meticulous and rigid regulatory process of the judicial procedure.

The parties are given freedom to determine how the mediation will develop, always with the help of the figure of the mediator. This can be developed according to pre-defined rules adopted by a specialized chamber, or according to rules freely agreed between the parties by a mediator not belonging to any chamber. The parties may be assisted by counsel.

Mediation is conducted by the mediator in as many daily sessions as are necessary, in the presence of the parties. These sessions usually take place for a whole day, with the intervals that are necessary. It is convenient that the parties choose a pleasant place for the sessions, with a welcoming and comfortable and, of course, neutral atmosphere. The mediator, when he deems it necessary or upon request, may meet privately with one of the parties, in separate sessions.

Another point in favor of mediation is celerity. In the judicial process, the litigants have no control over the procedure and duration of the lawsuits, being at the mercy of the Judiciary. In 2016 alone, the Brazilian Judiciary judged the

record of 30.8 million cases. Still, only 27% of all the cases judged in that year were finally settled.[1]

The excessive quantity of litigations brought to the State power, coupled with the rigidity of the judicial procedure, explains why mediation is an advantageous alternative to the process. While in Brazil one case takes, on average, 1 year and 9 months, only in the lower courts[2], mediation takes a much shorter time, and can be concluded, in most cases, in just a few weeks.

If it is impossible to reach a solution to the conflict in the process of mediation, or if there no longer exists room for any attempt at dialogue, the parties are free to terminate it. On this point, it should be pointed out that the success rate in mediation processes in the United States, that is, processes that culminate in the conclusion of an agreement by the parties, is an impressive 83%[3].

The low cost of the process also makes its adoption very attractive. The mediation chambers, *in general*, charge a management fee to initiate a mediation process and their mediators are remunerated per hour spent in the process. In the case of a procedure conducted outside the context of a specialized chamber, the mediator stipulates remuneration on an hourly basis. In one way or another, there is no possible comparison between the relatively modest costs of the mediation process and the high costs of legal proceedings or arbitration.

No less relevant and attractive, in relation to the mediation process, is the principle of confidentiality. Anything that is said in the course of the proceedings[4], by one party to another[5] during the joint sessions shall be confidential in relation to third parties and may not be disclosed even in judicial proceedings or arbitration. In addition, anything that is said by a party to the mediator in any secluded session is also confidential and cannot be disclosed

1 Detailed information regarding the above data can be found on p. 65 of the Justice in Numbers Report (2017), prepared by the National Council of Justice.

2 Idem, p. 128.

3 The above-mentioned success rate is reported in the Dallas Mediation Project (Statistics on Mediation in the 101st District Court as of June 12, 1992).

4 As explicitly provided by art. 30, § 3, of the Mediation Law, information regarding the occurrence of a public action crime is not covered by the confidentiality rule.

5 According to the Mediation Law, the duty of confidentiality applies to the mediator, the parties, their representatives, lawyers, technical advisors and other persons of their trust who have directly or indirectly participated in the mediation procedure (art. 30, § 1).

by the mediator to the other party. For this reason, the mediator cannot act as an arbitrator or act as a witness in judicial or arbitration proceedings related to conflicts in which he has acted as mediator.

This principle is largely responsible for the high success rate (agreements reached) of mediation processes, as it holds important value for the parties: the assurance that everything that is said in the course of mediation will be protected by the seal of confidentiality. When entering into a process of private negotiation, mediated by a neutral and impartial third party, technically trained and able to facilitate dialogue and understanding between the parties to the conflict, with which one can converse unreservedly, even privately, the chances of reaching a solution to the controversy greatly increase.

The confidence that what is said cannot be used by the other party means that differences and misunderstandings may be stated frankly, allowing the proper delineation of the conflict and, more than that, the precise identification of the real interest of the parties – that which underlies their original concrete claims. A skilled mediator will be able to formulate the right and necessary questions to lead the parties to the satisfaction of their mutual interests, through mutual concessions that are smaller and possible.

If there is agreement on the solution to the conflict, the procedure will be terminated with the drafting of its final term, which is an extrajudicial binding and enforceable document.

23.2 Regulation of mediation as a global phenomenon

It is not by chance that mediation has been encouraged in the last decade in several countries – mainly European and the United States. The recognition of the advantages offered by this process in the solution of controversies motivated the creation of normative laws aimed at the regulation of this alternative method of conflict resolution. The observation that the Judiciary Branch is overburdened has long been a matter of concern for lawmakers in many countries.

It was from this perspective that Directive 2008/52 of May 21, 2008 was issued by the European Parliament, together with the Council of the European Union, whose main objective was to stimulate and encourage the use of

mediation, in case of cross-border disputes[6], at a European level in civil or commercial matters.[7]

In compliance with the European directive, for example, Legislative Decree nº 28/2010 of the President of the Republic was published in Italy, which regulates the mediation procedure in Italy. This decree is concerned with explaining certain characteristics of mediation, such as (i) non-submission of mediation acts to the procedural formalities; (ii) the duration of up to three months of the procedure; and (iii) confidentiality.

Likewise, Spain incorporated into its legal system the provisions of Directive 2008/52, when it published Law nº 05/2012, of July 07, 2012, responsible for regulating and systematizing the mediation applicable to civil and commercial matters.

In the United States, a number of states have adopted the so-called Uniform Mediation Act, of August 2001 designed to standardize rules on the mediation procedure. In a manner similar to that carried out by the European countries, this law had the power to consolidate, in the internal legal system, certain characteristics of mediation – notably, the confidentiality and impartiality of the mediator.

In Brazil, although mediation was already widely sought as a means of settling disputes and was already provided for in the Civil Procedure Code, it was only with the advent of Law 13.140/2015 – the so-called *Mediation Law* – that this method of dispute settlement has received systematic legal treatment.

Like foreign normative laws, the Brazilian Mediation Law was concerned with highlighting the basic principles of mediation, such as confidentiality, orality, informality, the mediator's impartiality and the party autonomy (which means the impossibility to constrain the party to remain in a mediation procedure).

23.3 Mediation in the oil and gas sector

As discussed above, mediation is a very attractive means of resolving conflicts, ranging from family disputes, to complex commercial contracts or controversies between partners in large companies.

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6 In summary, cross-border disputes are those where at least one of the parties is domiciled or habitually resident in a Member State of the European Union, distinct from any of the other parties, at the time the dispute arises. Article 2 of Directive 2008/52 deals with the possibility of cross-border litigation.

7 Of course, mediation cannot be used as a method of settling litigation involving rights that does not accept negotiation. Article 1 of Directive 2008/52 emphasizes that disputes relating to tax, customs or administrative matters, or related to State liability, cannot be settled through mediation.

With regard to the Oil and Gas sector, specifically, mediation seems to be a very advantageous resource for the conflicting parties.

Given the highly specialized nature of this sector, as well as its own rules, it is appropriate for the parties to the conflict to retain control over their solution so as not to be surprised by a decision imposed by a third party that may be unsatisfactory to both parties. In view of the high investments involved in the sector's undertakings, taking such a risk is undesirable. As we have seen, mediation allows precisely this control of the parties on the solution of the conflict. There will be no surprises!

Because it has an eminently negotiating – and not adversarial – nature, mediation has, as stated, the prerogative of preserving pre-existing commercial relations between the parties. This feature is extremely relevant for the players of the oil and gas sector because it allows them to retain their often long-standing trading partners and move forward with the long-term contracts already in place, sometimes essential for the continuation of activities.

The speed of the procedure is also attractive to companies in the industry. These have the need to resolve disputes as soon as possible. Companies do not want to enter into disputes which end up delaying the execution of contracts and provision of services, delaying payments and generating large financial losses.

The low cost of mediation is another aspect of interest to industry players. In cases of appeal to the judiciary or arbitration, the costs of resolving the conflict will certainly be much greater than those incurred in the mediation process.

23.4 Conclusion

In our view, mediation deserves to be encouraged in the Oil and Gas sector, since it offers essential advantages to the companies involved, when they have conflict situations to solve.

Factors such as celerity, self-composition (non-imposition of a third party decision, which may not know the specifics of the sector so well), cost reduction, confidentiality and preservation of pre-existing relationships between the parties justify its adoption on a large scale.

It is known that the agents of the sector are practically the same and their positions and interests are repeated, as well as the contracts signed and the

resulting conflicts. Basically, this is a well-known network of suppliers of goods and services to oil companies. The maintenance of the commercial relationship between these agents is therefore essential for the success of their economic activity and it is not reasonable to admit that a conflict is sufficient to cause the breach of a long-term and profitable contractual relationship.

This reality would justify an institutional commitment on the part of these agents towards the adoption of mediation as a way of resolving conflicts in the sector, strengthening the process as a whole.

As a suggestion, it is necessary to consider the creation of a specialized controversy mediation chamber arising specifically from the Oil and Gas sector, in order to confer greater speed, economy and safety to the agents of the sector when submitting their conflicts to mediation. The broad understanding of a recurring conflict in this area has the potential to enable the mediator to better understand the causes of the conflict and , with experience and time, to approach the controversy and conduct the process in a way that optimizes the search for the consensus in a quicker and more satisfactory manner for the parties.

For the time being, a healthy habit to the sector would be the inclusion of a mediation clause in contracts related to negotiation in this area, making a provision for the parties, in case of conflict, to first resort to mediation, and then, in case of failure, pursue other means of settlement, such as arbitration or the Judiciary.

In this regard, the contractual provision of mediation shall contain at least the deadline for the first meeting, its location, the mediator's selection criteria and the penalty in case of non-attendance of the party invited to the first mediation meeting. Alternatively, the above items may be replaced by the indication, in the mediation clause, of a regulation published or adopted by a mediation chamber, which clearly states these criteria.

PART VII

THEMES RELATING TO NATURAL GAS AND LNG

24. The integration between the production of natural gas and the generation of electric power

Ricardo Martinez de Almeida

Much has been said about the integration between the production of natural gas and the generation of electric power in Brazil, since they are two quite diverse markets whose industries have developed from different dynamics. The issue seems so much more controversial, and interesting, when you note that, even in mature economies and with markets operating for much longer than in Brazil, there still exists significant barriers among business, regulatory and operational models between the two industries.

The integration with the electricity sector is still one of the challenges for the natural gas industry in the country, since that sector corresponds to approximately 50% of the market of the latter. The relationship is still marked by tension, since, on one hand, the energy area calls for the flexibility of the thermoelectric plants fired by the fuel, while, on the other hand, the gas market wants its inflexibility. With a good forecast of natural gas supply for the coming years, there is a need to have a local market for this amount available.

"We need to create mechanisms so that the gas can be sold in the country", said the director-general of the National Agency of Petroleum, Natural Gas and Biofuels (ANP), Décio Oddone, who took part, on September 26, 2017, in the Seminar on Natural Gas, held by the Brazilian Petroleum, Gas and Biofuels Institute (IBP) in Rio de Janeiro.

The importance of gas thermoelectric plants comes on the heels of the great insertion of renewable sources in the Brazilian matrix, whose operational nature is intermittent. Thermoelectric plants arise naturally as support to these sources, since they are dispatchable. In this scenario, the thermoelectric plants fired by Liquefied Natural Gas (LNG) terminals play a prominent role, since the supply of this input is abundant today, due to the increase of the world

production of natural gas and, especially, by the growth of the production of the North American shale gas.

The Gas to Grow Program (*Gás para Crescer*), a proposal created by the government to change gas market rules in order to attract more investment, is one of the hopes for the market increase. On the other hand, Public Call 33, which deals with the new model for the electricity sector, also foresees changes. Both proposals must be prepared to be sent by the government to the congress, which in turn will hardly address the issue in the near future, even due to the approaching 2018 elections.

In view of the foregoing, these comments are not intended to offer solutions to the issue, but merely to situate the reader on the principles of the discussion now underway within the Gas to Grow initiative, which, indeed, seeks to achieve answers to the problems of integration of the industries in question.

24.1 History of oil and natural gas legislation in Brazil

In this regard, we would like to draw the reader's attention to the Primer on the Petroleum Law in Brazil (Vieira Rezende Advogados, Ed. Lumen Juris, RJ, 2016), a work coordinated by the renowned Dr. José Carlos Ribeiro Filho, which exhausts the subject in its Part I, more specifically in its items 1, 2 and 3.

24.2 A brief history of the electric power generation legislation in Brazil

In the last twenty years, the Brazilian Electricity Sector has been the target of a series of changes introduced by the Federal Government. Traditionally, the generation, transmission and distribution of electricity in Brazil was characterized by the centralization and strong presence of government-owned companies, whether federal or state. Over the years, several government-owned companies have been privatized, a regulatory agency has been created, and a new private sector has been introduced as a market participant.

In the mid-1990s, following a restructuring project in the Brazilian electricity sector, called Reseb, the Ministry of Mines and Energy prepared the institutional and operational changes that culminated in the current model of the sector.

With the publication of Law nº 9,074/1995, which established rules for granting and extending concessions and permits for public services, the sector began to become more flexible, mainly with the introduction of the figures of the Independent Electric Power Producer and the Electric Power Self-Producer.

The publication of Law nº 9,427/1996, which governs the scheme for concessions of public electricity services and lays down other provisions, established the Brazilian Electricity Regulatory Agency (Aneel), in order to regulate and oversee the production, transmission, distribution and commercialization of electricity in Brazil.

In order to restructure the electricity sector, the model adopted in Brazil based on the abovementioned statutes was characterized by the separation of services inherent in the sector and to inhibit the verticalization of industry activities, such as the generation of power energy and its subsequent transmission and distribution. The decentralization of the electricity sector also lacked the existence of control and inspection agencies for the facilities and services of the industry, and so they were created, besides the abovementioned Aneel, the Wholesale Energy Market (MAE) and the National Electrical System Operator (ONS), by means of Laws nº 9,648/1998 and nº 10,433/2002, as well as Decree nº 2,655/1998, which regulated the MAE and defines the rules of organization of the ONS.

Despite the changes introduced in the Brazilian Electrical System (SEB), the country sustained an energy rationing in 2001. Some scholars in the sector attribute the rationing, among other factors, to the lack of effective planning and effective centralized monitoring. It was then that, as from 2004, new adjustments to the model were made by the government with the purpose of reducing the risks of power outages and improving the monitoring and control of the system. In 2004, Laws nº 10,847 and nº 10,848 were sanctioned, the first one creating the Energy Research Company (EPE or *Empresa de Pesquisa Energética*), and the second establishing the Institutional Model of the new Brazilian electricity sector (NMSE), and creating the Chamber of Electric Energy Commercialization (CCEE), which absorbed the duties of the MAE and its structures (see also Decree nº 5,177/2004).

Despite significant changes in some of the mechanisms initially expected, such as the purchase of energy on the part of distributors, it can be said that the backbone of the 1990s model was preserved in 2004. However, a new chapter in the history of the electricity sector began with Provisional Presidential Decree

579, dated September 2012. In this Provisional Presidential Decree, later converted into Law nº 12,783/2013, generating and transmission companies were able to renew their concession contracts in advance, provided that their prices were regulated by Aneel. Mainly due to the regulation of the prices of the generating companies that accepted the terms of the Provisional Measure, there was a significant change in the institutional context of the electricity sector: *generating companies that once operated in a competitive environment started to have their prices regulated*, just as it already happened with the distributors and transmission companies, considered as natural monopolies.

24.3 Jurisdiction to legislate on the matter – Federal Constitution (CF)

The Federal Government has law-making power to provide for energy, as can be seen from article 22, item IV of CF/1988. It happens that, within the energy subject, it is also included the natural gas, whose standardization reaches other jurisdictions attributed to the other federated entities.

The constitutional legislator, in drafting the Federal Constitution of 1988, did not define a criterion for differentiating what would be the activities of *transportation and local distribution of piped gas*. In fact, it assigned to the Union the power to legislate on transportation activities (CF/1988, article 177, IV, § 1, coupled with article 22, VIII and XI), while granting to the Member States the power to legislate on local piped gas services (CF/1988, article 25, § 2), which can give rise to disagreements between the federated entities, considering the possible interpretations of what are, after all, such local piped gas services, since the transportation of natural gas, although it can be done by sea or river (vessels), or even by road-rail (trucks and trains), in fact takes place, in the vast majority of cases in Brazil, also through gas pipelines.

Although the Petroleum Law has brought technical definitions to conceptualize each segment of the chain, it is the responsibility of the Federal Supreme Court to safeguard the Constitution, with the consequent interpretation of its rules. Within this context, it can be argued that the Federal Law that provides for powers assigned to the Member States will suffer from the vice of unconstitutionality by breaching the federative form of the State.

As a result, almost all the Member States have incorporated government-controlled private companies holding the state concession to operate local piped gas services (distribution network), in addition to having established their respective regulatory agencies, some of them, such as the States of Rio de Janeiro and São Paulo, have already privatized their utility companies.

24.4 Main contracts of both industries

The Power Purchase Agreement (PPA) is the commercial contract for the purchase and sale of electric power, the purchaser being the consumer (or distributor) of electric power, and the seller being the generator. It basically determines the amounts traded, the electric energy traded, the conditions, terms and clauses for inflation adjustment and price increase, termination and penalties.

The Gas Supply Agreement (GSA) is the commercial contract for the purchase and sale of natural gas (also compressed or liquefied-LNG), the purchaser being the consumer (or distributor) of gas, and seller being the producer, basically establishing the traded values, the gas and its composition, conditions, terms, inflation adjustment and price rises, in addition to the conditions of withdrawal of noble fractions (when applicable), volumes and other usual contractual clauses, including penalties.

The Gas Transportation Agreement (GTA) is the contract for the transportation of natural gas (also compressed or LNG), the loader being the service taker (or shipper) and the carrier being the service provider (including through gas pipeline), basically establishing the volumes, price, conditions, composition, terms and locations for loading and delivery, as well as other usual clauses, including penalties.

It should be noted that each of the abovementioned agreements follows the regulatory, production (or service) and market logic, which are different from each other.

24.5 Differences in the transportation of gas – Modalities

As we have already had the opportunity to comment on above, thermoelectric plants fueled by liquefied natural gas (LNG) are in evidence

by the abundance of supply, due to the increase in world production and, mainly, to the North American shale gas. In this respect, it should be noted that LNG is a natural gas subject to huge atmospheric pressures through cryogenic processes, in such a way that it liquefies, thus concentrating much more quantity per volume than compressed natural gas, optimizing its transportation by vessels, trains or trucks.

The Brazilian production of natural gas is ever increasing, thanks also to the pre-salt volumes. In addition to the national gas, Brazil also imports large amounts of the product from Bolivia, through the Bolivia-Brazil Gas Pipeline (Gasbol), and from other countries in the form of LNG using special ships for this transportation, which dock in Brazil at the already existing LNG terminals. In the latter case, the LNG is regasified and injected into the transportation network (or distribution, as the case may be) to be delivered to the end consumer.

On the other hand, the gas liquefaction process, as well as its subsequent regasification for final use, is still quite expensive compared to the simple compression for transportation by the same modes, and much more expensive than the natural gas transported by gas pipeline, which uses compression only to move the molecule inside the pipe. The problem then becomes the availability of the product (national or imported natural gas), and logistics for the supply of fuel to the thermoelectric plants (the existence or not of gas pipelines and capacity availability), in order to produce the electric power at the lowest possible cost. This calculation also includes the costs of electric power transmission, with other specific variables. Hence the great importance of the location of the thermoelectric plant itself for the final cost of the electric power produced and its competitiveness in the auctions held by Aneel.

In view of the foregoing, it should be noted that the PPA, in order to keep the market logic, must cover at least the entire cost of financing and producing electric power, including that of the fuel used (in this case, natural gas) and its delivery logistics (transportation, distribution and regasification, as the case may be), in addition to the taxes levied. As both industries have different logic and regulation, as mentioned above, integration between sectors is not a simple task.

For the consultant Adriano Pires, the only place where the integration between gas and electricity sector actually took place was in Parnaíba, where Eneva has gas fields and a thermoelectric complex. According to Pires, the history of gas in Brazil still needs to be *written*. He explains that previous

governments have already had opportunities, such as in the 1990s and the establishment of the Gas Law, to make that market take off, but they preferred to neglect or strengthen Petrobras' monopoly.

Now, he says, there is a new chance, since there is a growing supply of gas in the world, with LNG and shale gas. In Brazil, in addition to the high supply, Petrobras will still sell part of its assets. Also according to Pires, the Brazilian government has a tendency to be too interventionist, not believing in the market. If the government wants market, it must create legislation to facilitate this. "The book is blank, you have to decide whether you want to be marked or not", he points out. (Source: Canal Energia, October 02, 2017)

24.6 Differences between thermoelectric plants in isolated markets or dispatching at the base, and those interconnected with dispatch by ONS authorization

It is important to note that SEB is composed of the National Interconnected System (SIN), covering most of the country, and Isolated Systems, notably in the North Region. Thus, the energy produced in one region can be delivered to another region using the interconnection of the system, except in the case of isolated, non-interconnected systems.

In this way, in the case of a thermoelectric plant located in Isolated System, or even if it is dispatched at the base (constant, uninterrupted dispatch), the suitability of the two industries is a less complicated task, to the extent that the thermoelectric plant will always use certain volumes of gas according to the forecasts. In this case, the GSA must have constant volumes or in predefined ramps, and the gas purchaser will have no problems with a possible Take-or-Pay clause, usually required by the gas seller to ensure the repayment of its investment so as to guarantee the delivery according to the agreed volumes and deadlines.

In the case of the hypothesis, likewise, the gas purchaser should not have problems with a possible Ship-or-Pay clause in the gas transportation, which is normally required by the carrier, in the same way as the gas seller, to guarantee the capacity of transportation in the volumes and deadlines agreed upon.

Differently from the hypothesis above, when the thermoelectric plant relies on the ONS dispatch to produce power, which normally depends on the hydrological variations in the different regions of the country, the situation gets complicated. In effect, if the thermoelectric plant does not know for sure when and for how long it will produce energy, it will also not know for how long it will need the volume of gas required to produce it. Accordingly, the financial amounts that are necessary to ensure the supply and possible storage of natural gas in compatible volumes can make the final energy price prohibitive, which requires sophisticated calculations based on the hydrological retrospect in Brazil, which in turn are rapidly changing and making this *futurology exercise* difficult.

Remember that in Brazil there are still no specific deposits for storage of natural gas (salt caves, special tanks, etc.), a product that disperses naturally and easily. Even LNG has a daily natural loss rate. So, in practice, it is the gas pipeline network that has served as the *storage* of natural gas, which is clearly not the ideal situation.

One of the alternatives under study to mitigate the problem is the creation of an interruptible spot market, therefore, with capacity to absorb the volumes not used by the thermoelectric plants while not dispatched. Other alternatives under study are the attempt to suit the current legislation in order to approach the concepts of both industries, or even seek to make specific agreements compatible with respect to penalty clauses. In this regard, it should be noted that the energy market is much larger than the natural gas market, which may, from time to time, lead to problems for the natural gas industry in view of penalties based on the cost of the energy that is no longer produced, due to possible supply failures.

At this moment, we would like to once again draw the reader's attention to the already mentioned Primer on the Petroleum Law in Brazil (Vieira Rezende Advogados, Ed. Lumen Juris, RJ, 2016), which in its item 22 addresses the Limitations on the Duty to Indemnify within the Scope of Oil and Gas Industry Contracts.

24.7 Conclusion

The *Gas to Grow* Program concerns the discussion of the guidelines for Brazil's new natural gas market, which were put on public consultation on November 03,

2016, on the website of the Ministry of Mines and Energy (MME). The document *Strategic Guidelines for the Design of a New Natural Gas Market in Brazil*, developed by the MME, together with EPE and ANP, laid down the basis for discussion of relevant issues with various industry players, such as Brazilian Association of Piped Gas Distributors (Abegas); Brazilian Association of Investors in Self-Production of Energy (Abiape); Brazilian Association of Large Industrial Energy Consumers (Abrace); Brazilian Association of Energy Marketers (Abraceel); Brazilian Association of Thermoelectric Generators (Abraget); Brazilian Association of Independent Power Producers (Apine); MME; Aneel; ANP; EPE; IBP; ONS; Electrical Energy Research Center (Cepel), and bodies of the Ministry of Planning and of Petrobras, which is why it has high expectations for its improvement and future results.

> "From the regulatory perspective, the types of market implemented in the gas and electricity sectors define the extent and dynamics of their interdependencies. Flexible market structures facilitate this practice, required to strike a balance between the prices of the two commodities. For example, in mature markets, companies can arbitrate between consuming gas to sell electrical energy in the electricity market, or reselling in advance gas agreements in the gas market and buying electrical energy to meet their commitments. This allows an interaction between prices in the electricity and gas market, correctly signaling the value of each product. Currently, only the United States has significantly liquid gas spot markets that operate relatively smoothly with its electricity spot markets, thanks also to the high production and extensive gas pipeline infrastructure already available at the time of the implementation of such markets. Even so, in the United States there is so much discussion on how to increase the convergence of these two industries." (Excerpt *Annex 5: Harmonization of Natural Gas and Electric Power*)

Notwithstanding all the current discussion on the topic proposed in these comments, it is interesting to note that not only are thermoelectric plants fully operational in Brazil (in Isolated and Interconnected Systems), but also that new projects appear with some frequency, as is perceived of the last auctions carried out by Aneel. If new projects arise even against the current difficulties, we believe there is no reason to fear any stagnation of natural gas electricity production, even though this fuel has obvious advantages in price and level of aggression to the environment compared to other available fuels.

25. Natural gas in Brazil

Ricardo Martinez de Almeida

25.1 What is natural gas

Natural gas has a fossil origin, resulting from the decomposition of organic matter inside the Earth. It is composed of a variable mixture of gases, in which methane gas predominates, and presents itself in nature in an odorless and colorless form, normally being perfumed artificially before being distributed to the final consumer, for safety reasons.

The combustion of natural gas results in carbon dioxide and water vapor, which makes this fuel a safe source of energy, with reduced emission of pollutants and it can be used in industry, commerce, vehicles and households.

In industry, natural gas is used as a source of heat, electricity and power generation, as well as raw material in the chemical, petrochemical and fertilizer sectors. Also used in the transport sector, this fuel has wide use in homes and buildings in general, for heating environments, sanitary waters, and for cooking.

Natural gas reserves are vast and geographically dispersed, with known conventional reserves accounting for more than 200 years of current global consumption.

25.2 Brief history

Although known from ancient Persia between 6000 BC and 2000 BC when, according to some historical indications, it was used to keep lit the *eternal fire* – symbol of a local sect, natural gas was discovered in Europe in the seventeenth century, though without awakening much interest, since the public lighting gas in Europe, from 1790, was produced from coal.

In 1821, the streets of Fredonia, near New York, were lit by natural gas, simply because it burst from a hole in the ground, just outside the city. The pipeline was made of wood and lead, and one could imagine the insecurity generated by

people, both in terms of potential explosions and in terms of poisoning. Due to the lack of reliable mechanisms to transport it to homes, natural gas was not used for heating, cooking and other commercial or industrial uses, and was used only for public lighting. Since the beginning of the 20th century, electricity has replaced gas and has become the main source of illumination.

It was after World War II that transportation of gas by pipeline began to grow. These were the advances resulting from the war, metallurgy, welding and the production of better quality pipes that allowed the rapid development of gas transportation. As transmission and distribution networks expanded, industries and power plants became important customers of natural gas. Natural gas is currently widely used for the production of electricity, and combined cycle technology has contributed much to this fact, with a yield much greater than conventional thermal power plants.

Concerns about global warming and sustainability have reinforced the role of natural gas as a global energy source. Natural gas is a convenient, safe, cleaner and more competitively priced energy source than other commonly used fuels (coal, oil, etc.). These characteristics make natural gas the most suitable energy source for a wide range of uses. It is currently the main source of energy used by most countries in Europe, Asia and North America, as well as various countries on other continents in the domestic, tertiary and industrial sectors. Even ships are being converted for the use of natural gas, and by 2020 several major ports in the world will be closed for ships with fuel oil. (Source: Portuguese Association of Natural Gas Companies – AGN)

25.3 Natural gas in Brazil

The history of the use of gas in Brazil begins with the installation of the first gas lamps produced from coal in Rio de Janeiro in 1854. Throughout the 20th century, bituminous coal and naphtha were also used for the production of gas, and liquefied petroleum gas (LPG) began to be used for cooking in 1936.

Natural gas began to be used in Brazil in the 1950s, with its production beginning in the Northeast region, in the state of Bahia, when it was practically all destined to industries. Brazil's climatic factors did not pressure local production, as it was considered unnecessary for indoor heating, unlike other continental countries, such as Argentina and Chile. In the Southeast,

this fuel began to be produced in the Campos Basin, in the state of Rio de Janeiro, in the 1980s.

Some government plans were started in the second half of the 1980s, when contracts were signed for the purchase of natural gas from the Campos Basin to São Paulo. The National Natural Gas Plan (Plangas) of the Ministry of Mines and Energy, launched in 1987, did not have conclusive results. It was followed by a second plan, initiated in 1992, with the objective of increasing the share of natural gas from 2% to 12% in the energy matrix by the end of the 1990s. (Source: Notebooks FGV Energia 2014)

It is important to note that, from the second half of the 1990s, the Brazilian government decided to purchase natural gas from Bolivia, and for that purpose it started the construction of the Bolivia-Brazil Gas Pipeline (Gasbol), all through Petrobras. Petrobras entered into natural gas purchase and sale agreements with its Bolivian counterpart, and built Gasbol to import the gas through the state of Mato Grosso do Sul, and take it to the state of Rio Grande do Sul, passing through the states of São Paulo, Paraná and Santa Catarina.

At that time, it was believed that the increased availability of natural gas provided by increased domestic production, plus imports from the neighboring country, would be sufficient to develop the domestic market for natural gas. However, although the Brazilian market demand was large, the costs of building the necessary infrastructure, plus the price of imported natural gas, meant that the final price of the fuel was well above the national natural gas price.

In view of the need to stimulate the construction of thermal electric power plants to meet the deficiencies of the Brazilian electricity system, in the year 2000 the Government created the Priority Thermoelectric Program (PPT), which planned for the immediate construction of thermoelectric plants fueled by natural gas throughout the country. However, among the conditions of the PPT, it was stated that Petrobras should supply large quantities of natural gas to the future thermal plants at differentiated prices; which, in addition to other regulatory deficiencies in both the natural gas and electric fields, led to the insufficiency of installed power and the 2001 electric crisis, popularly known as *blackout*.

In 2006, Petrobras launched another Plangas, the Natural Gas Production Anticipation Plan, considering projects in exploration and production, processing and transportation of natural gas, in order to increase the supply of natural gas to 55 million cubic meters per day by the end of 2010.

In the last decade, Brazilian natural gas reserves have increased considerably, especially after the discovery of associated oil and gas in the pre-salt layers off the Brazilian coast. As well as the reserves, natural gas consumption has also increased in the last decade, even causing Brazil to import liquefied natural gas (LNG) to serve part of the market represented by thermo-electric plants. (Source: Institute of Energy and Environment – University of São Paulo)

25.4 Conclusion

Recent history shows that natural gas, because of its characteristics as a fuel, has always revolutionized markets and induced the industrial development of regions that have adopted it as a significant part of their respective energy matrix.

In Brazil, although it is still not necessary for indoor heating in most of the territory, natural gas is already widely used in homes for water heating and cooking, as well as in transportation, commercial, industrial and electric energy production. If we take into account the fact that we are a country that still has frontiers to be pioneered and developed, the importance of natural gas among us and the necessary infrastructure for its efficient use is even greater.

POSTFACE

26. The recovery of Oil and Gas sector after 2016

José Carlos Ribeiro Filho
Carlos Maurício Maia Ribeiro

The originals of this second issue of the Manual on Petroleum Law in Brazil are being sent to the publisher on the eve of a new edition of Rio Oil & Gas and, more importantly, of the general elections of 2018, and should be published when the country has already chosen a new president of the Republic, who will have, among his/her many and urgent responsibilities, to lead, in partnership with the National Congress and Brazilian society, the process of recovery of the frail national economy. In this difficult and urgent undertaking, the new government will count, from the outset, on the two sectors of the economy that, when well-regulated and administered, have a huge capacity to generate wealth. These are the Agribusiness, which has been the great bulwark of the Brazilian economy, and the Oil and Gas Industry (O&G), which is showing clear signs of recovery.

In effect, after four years of severe economic crisis, of which two were of depression, a period during which the O&G industry has suffered so much, either because of the drop in the international price of the barrel of oil or because of the misguided regulation of the sector, or even due to the disruptions that took place in the heart of and surrounding Petrobras, the fact is that, since the end of 2016, this industry has begun to react. This reaction has its origin at the moment in which the two main representative entities of the sector, IBP and ABESpetro, started working together to convince the Federal Government and the National Congress, still in the throes of Dilma Administration, of the necessity of changes in the regulatory framework of the O&G industry in the country.

It was this coordinated action, to which other entities and some companies also contributed, that laid the foundations of the recovery that began two years ago, already in the Temer Administration, which could be felt by the optimism, although cautious, observed in the timid edition of Rio Oil & Gas held in 2016.

The main reason for such optimism consisted of the realignment of government policy for the sector, which was no longer oriented by a misguided political-economic ideology and started being led by more clairvoyant politicians and more skilled technicians. Clear examples of this virtuous change of direction are the praised performance of the young Minister of Mines and Energy and his technical staff; the appointment of a Director General for the ANP from the private sector, with wide experience and great managerial skills, which regained the relevance and mission of that regulatory agency and, not less important, the appointment of an experienced and successful crisis manager for the presidency of Petrobras, who firmly and efficiently conducted the profound managerial shock in the then weakened and discredited corporation, whose positive results have already been observed since the middle of the current year.

In this period of transition and hope, an unprecedented alliance arose between the Federal Government, the National Congress and the O&G Industry, forged in hard work and in pursuit of a common goal, namely the recovery of such an important sector of the Brazilian economy, an alliance which was strengthened in the mutual trust that ended up being established among the various actors of this tough undertaking. This alliance and sharing of goals were most clearly felt in the last two editions of the OTC in Houston, where the harmonious and coordinated performance of the Brazilian public and private sectors sent the necessary message that Brazil was correcting its course and the O&G industry was a fundamental part of such a change.

And the results of this drastic and necessary change have already been felt by the great success of the post-salt and pre-salt auctions held in 2017 and 2018, a result largely due to changes in the pre-salt legislation, which led to (i) the release of Petrobras from the obligation of being the sole operator, while making the Pre-salt areas more attractive to the other oil companies; (ii) the extension of Repetro (Special Customs Regime) until 2040 and creation of Repetro-sped; (iii) flexibilization of local content requirements; (iv) Petrobras divestment program; (v) the establishment of a calendar of auctions of the post and pre-salt areas for the coming years, and (vi) the permanent offering of exploration blocks, among other measures.

A lot still needs to be done to consolidate the recovery of the O&G Industry in Brazil and to feel its beneficial effects, such as creation of jobs, generation of income, money and dividends, investments in infrastructure and PD&I, and the reconstruction and growth of the local sector of services and equipment. It

is, therefore, essential that the new Federal Government and the new National Congress, which will take office in January 2019, become aware of the imperative need to keep the virtuous alliance between State and industry, forged with hard work and dedication, at a dramatic moment in national history, which was certainly the most difficult for the Brazilian O&G industry ever.

The most recent forecasts, based both on macroeconomic elements, as well as on geopolitical factors, indicate that the Petroleum Industry will continue to be one of the main generators of global energy for a long time to come, maintaining its relevance in the world energy matrix, to the extent that it includes both petroleum, which will continue to have its traditional applications for decades, and natural gas, which will be the main fossil fuel in the transition to a low carbon economy. In this context, our industry continues to evolve and modernize, making the exploration and production of hydrocarbons in deep and ultra-deep waters possible, with special mention of the already successful exploration and production in the oil province of the Brazilian Pre-salt layer, which is acknowledged by the international market as the most attractive offshore area in the world. This new exploratory frontier has brought the need to develop sophisticated equipment and technological innovations, as well as the improvement of regulatory, tax, labor, environmental and operational safety standards, together with the preparation of contracts and guarantees to encourage the participation of investors. This second Volume of Manual on Petroleum Law in Brazil covers all these themes in an objective way, providing immediate comprehension of the topics included herein.

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