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LOCAL CONTENT



Overview

Local Content ("LC") could have broader meaning depending on the context and jurisdiction. LC norms can be applied using the concepts of territoriality or nationality depending on the policy adopted by each country. In Brazil, LC is the value added in the Brazilian territory for the production of a good and service, following the guideline of the National Organization of the Petroleum Industry (ONIP, 2010). LC basically refers to the Brazilian based inputs for the supply of goods and services necessary for the exploration and production of oil and gas in Brazil. Using the territoriality criteria, LC can be locally produced by either national or international capital owned companies, provided they use Brazilian inputs, including infrastructure and labor. The reason for the choice of the territoriality criteria by the Brazilian authorities is the fact that it fosters generation of value in Brazil¹. It was understood that using the nationality criteria, however, would limit the supply only by national owned companies and, therefore, the investments and wealth creation in the country.

LC obligations traditionally have either a legal or contractual nature. LC obligations established by law one could argue that would create an environment with a more solid legal certainty for E&P companies, however, the other could argue that a possible amendment to such legislation for any improvements based on lessons-learned would have to observe the applicable legislative procedure, which is never an easy task. On the other hand, LC obligations set forth in E&P contracts can be set during the bidding round and later easily adjusted to accurately reflect the economic scenario of the industry from time to time.

For this reason, there is no standard LC policy ("LCP"), as well as no single LC tool that works for all countries under all circumstances (TORDO et al., 2013). However, a successful LCP can be considered one that not only generates value for the country, but also stimulates others sectors of the economy, boosting the country's economic activity. In view of this, the LCP should foster the creation of an industrial and service provision sectors capable of competing internationally, and not only in the creation of a market reserve for local producers. Therefore, the LCP must enable a competitive and sustainable business environment, capable of operating not only nationally, but globally, aiming to create leading positions in the use of key technologies (ARAÚJO et al., 2012).

¹ MAGALHÃES, R., GUEDES, H., VASCONCELLOS, W. Conteúdo Local aplicado ao Setor de Óleo e Gás no Brasil. ONIP, 2011. Disponível em *Raquel_Filgueiras_de_Almeida.pdf (ufrj.br)

Brazilian Local Content Regulatory Framework

The enactment of Law No. 9,478/1997 (Petroleum Law) removed Petrobras' monopoly in the oil and gas exploration and production sector and enabled the entry of new agents in the Brazilian market. As a consequence, the market became heated and the demand arose in Brazil for the supply of goods and services in the oil and gas chain, which needed to be imported from countries with more experience operating in the sector.

Given this scenario, it was deemed necessary to adopt LC clauses in the first concession contracts signed in Round Zero promoted by Brazil's National Agency of Petroleum, Natural Gas and Biofuels ("ANP"). The LC clauses provided for a portion of the mandatory contracting of locally based suppliers by companies in the execution of exploration and production contracts of oil and natural gas ("E&P Contracts"), in order to promote the domestic industry and services providers and expand local supply capacity.

This contractual provision across jurisdictions typically consists in (i) an obligation of contracting domestic based suppliers, (ii) a preference right for domestic suppliers when on equal terms with offers from foreign suppliers, or (iii) an obligation to ensure equal opportunities between domestic and foreign suppliers.

Ever since the 1st Bid Round under the concession regime, LC obligations have been encompassed in E&P Contracts in Brazil, as they were originally one of the bidding criteria. At the beginning of 2017, the Federal Government started to implement several regulatory changes in the petroleum industry, including the removal of LC from the applicable bid criteria².

² CNPE Resolution No. 07/2017.



1st Bid Round

1999

To freely offer the percentage of acquisition of Brazilian goods and services to carry out exploration and production development activities.

5th Bid Round

2003

Requirement of minimum and different percentages for the acquisition of Brazilian goods and services for onshore blocks, shallow water blocks and deep water blocks.

7th Bid Round

2005

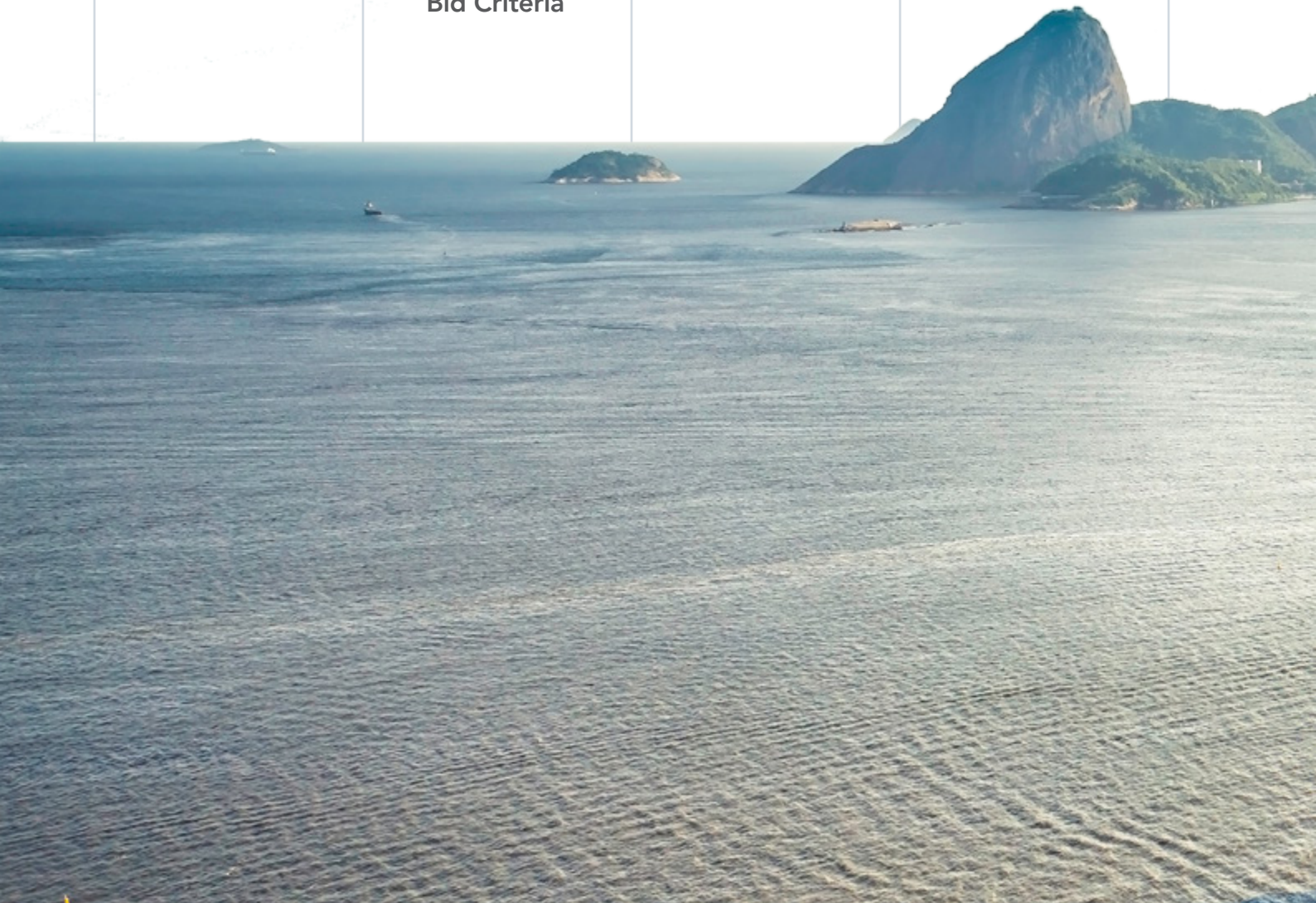
Offers limited to percentage ranges between minimum and maximum values, as well as the division of commitments into items and sub-items. The local content certification system was introduced, in which certification bodies accredited by ANP started measuring the local content in each good or service following a calculation methodology regulated in the Local Content Manual.

14th Bid Round

2017

No longer a bid criteria. Simplification of commitments and adaptation of minimum percentages. Elimination of the local content obligation exoneration mechanism.

Bid Criteria



In that context, LC has only a generic mention in Law No. 9,478/1997 (Petroleum Law)³. Thus, its legal nature in Brazil is eminently contractual (and not legal), based on the actual E&P Contract, having resolutions issued by the ANP for the regulation of its practical implementation aspects; and, measurement and certification.

Compliance with LC requirements must be proved by the contractor or concessionaire through the submission of LC certificates to ANP. In order to obtain them the respective company must request a certification process that involves an audit process to ensure they actually used Brazilian based inputs (and to which extent). The certificates are issued by third-party certifying entities that are accredited by ANP. Upon assessment of the certificates, if ANP verifies that the concessionaire has not complied with the relevant LC requirements, a penalty may be applied, corresponding to the difference between the percentage achieved and the percentage actually committed to.

³ Article 2 The National Energy Policy Council - CNPE, connected to the Presidency of the Republic and presided over by the Minister of Mines and Energy, is hereby created with the task of proposing to the President of the Republic national policies and specific measures aimed at: (...)

X - induce the increase of the minimum indexes of local content of goods and services, to be observed in bids and concession and production sharing contracts, observing the provisions of item IX.



The calculation of penalties is done as follows:

- If the percentage of LC not performed is **less than 65%** of the minimum LC, the fine will be **40% of the value of the LC not performed**.
- If the percentage of LC not performed is **equal or higher than 65%**, the fine will be **increased from 40%, reaching 75% of the minimum LC value, in case of 100% of LC not performed**.

ANP Resolution No. 726/2018: sets forth the criteria, requirements and procedures applicable to the exemption (waivers) of LC commitments regarding the concession contracts from the 7th to the 13th Bid Round, the Transfer of Rights Agreement and the Production Sharing Agreements concerning the 1st Pre-salt Bid Round (including the Concession Contract concerning the unit area adjacent to Gato do Mato – 2nd Pre-salt Bid Round), adjustments of percentage and transfers of local content surplus and it also regulates amendments to the local content clauses of E&P Contracts.

Exemption (Waiver)

According to the ANP Resolution No. 726/2018, the exemption of a LC commitment may be authorized in the event of:

- The absence of a Brazilian supplier;
- Offers from Brazilian suppliers with exceedingly expensive prices compared to the prices of foreign suppliers for similar goods/services;
- Offers from Brazilian suppliers with excessively long delivery time compared to the delivery times of foreign suppliers of similar goods/services⁴; and
- The absence of new technologies in Brazil.

The exemption request must be signed by the operator, accompanied with evidence and filed at the ANP until the deadline for the submission of the last LC Report of each LC Assessment, pursuant to the respective phase, stage or module.

⁴ It must demonstrate that the difference in delivery times between the Brazilian supplier and the foreign supplier compromises the fulfillment of the project's activities schedule, according to the contracting characteristics.

Adjustment of percentages and transfer of surplus

Also in relation to ANP Resolution No. 726/2018 regarding E&P Contracts, the ANP may exceptionally authorize the adjustment of an LC percentage, based on public interest, with regards to a certain item or sub-item of the LC commitments provided in the respective E&P Contract. In this case, the operator must request the adjustment, on special conditions, by the deadline for the submission of the last LC Report of each LC Assessment.

The operator is also allowed to request the transfer of LC surplus (if the concessionaries not only complied with the requirements, but also exceeded them) from the exploration phase to the development stage or from a section of the development stage to the subsequent section, depending on the result of the ANP's inspection.

Contract amendment

The ANP may apply LC commitments different from those in force under the concession contracts executed until and including the 13th Bid Round.

In this regard, each concessionaire that qualifies under ANP Resolution No. 726/2018 had to express its agreement to the new provisions and then execute an amendment to the relevant E&P Contract. The amendment established the following local content percentages:

- **Onshore blocks** – A global percentage of 50% for both the exploration phase and the development stage or for each development section.
- **Offshore blocks** – A global percentage of 18% in the exploration phase and in the development stage or in each development section, a percentage of 25% for well construction and 40% for the collection and offloading system. As to the commitments regarding the stationary production units, percentages were provided for three areas: 40% for engineering; 40% for machinery and equipment; and 40% for construction, integration and assembly.

The ANP Resolution No. 726/2018 also states that, by agreement of all signatories, the LC clauses under the Production Sharing Agreements and the Transfer of Rights Agreement may also be amended.

After the execution of the relevant amendment, the concessionaires can no longer be allowed to submit waiver and adjustment requests towards LC commitments, and proceedings that were previously submitted will be automatically dismissed. Furthermore, ANP Resolution No. 726/2018 establishes that concessionaires that opted to amend the E&P Contract must have waived any claim against the ANP relating to fines imposed for non-compliance with local content commitments.

- **ANP Resolution No. 833/2020:** allows the signatories of unitization agreements, commitments or annexation of existing areas the possibility of amending their respective LC clauses, choosing the clause of one of the E&P Contracts involved.

- **ANP Resolution No. 848/2021:** regulates the execution of Conduct Adjustment Agreements ("TAC") for non-compliance with the LC clause of E&P Contracts that are extinct or with concluded contractual phases. The rule provides for the replacement of the payment of fines by making new investments in national goods and services.

For a TAC to be executed, there must be a sanctioning administrative process which verified the infraction of non-compliance with LC commitments, and that such non-compliance is related to contracts not contemplated by the possibility of amendment provided for in ANP Resolution No. 726/2018.

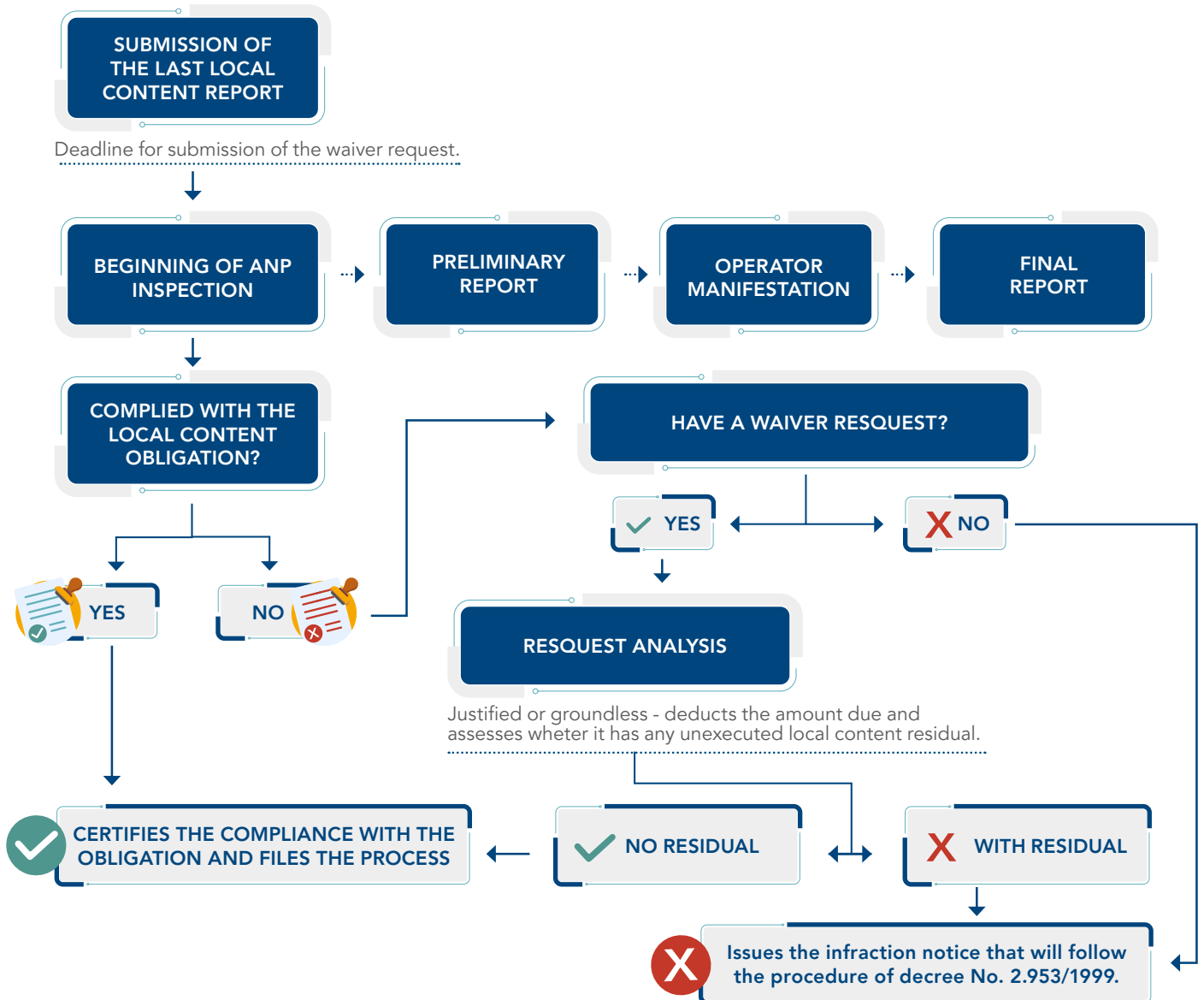
A TAC replaces the administrative sanction process by archiving it. However, in case of non-compliance with the undertaken commitments in each TAC execution period, a penalty will be applied, as a compensatory sanction clause, with its respective extrajudicial execution.

The undertaken commitments in the TAC must be implemented within six years. Companies interested in executing a TAC have until December 31, 2027 to submit an application to ANP.



Local Content Inspection

The LC inspection is also regulated by the ANP as per the flowchart below.



Companies have to submit the LC Report in order for ANP to start the inspections analysis. After that, the ANP will analyze if all the LC norms are being followed by the company and if not, the ANP will evaluate if there is a request for exemption. It is important to emphasize that if any LC norm (ANP Resolution No. 726/2018) is violated, the ANP may infract the company in compliance with Decree No. 2.953/1999.

Lusophone Countries' Local Content Regulatory Framework

A Comparative Analysis

MOZAMBIQUE

The Mozambican legal framework applicable to LC obligations uses mainly the nationality criteria (explained above) to assess the level of LC in a specific good or service. Similar to other LCPs, the Mozambican Government sought to create mechanisms to promote “the involvement of national entrepreneurship in petroleum enterprises” by using the nationality criteria.

The Mozambican LCP also establishes that preference must be given to local goods and service, provided that: (i) they are identical to those available abroad; and (ii) their prices no more than 10% higher than the imported ones.

A percentage of the revenues generated by petroleum activities is channeled in the State budget for the development of the communities where oil ventures are located. Concessionaires must promote the involvement of local communities in the labor force and resettle local communities located in project areas.

Other interesting aspects that could be considered as LC obligations are (i) the obligation of concessionaires to be listed in Mozambique's Stock Exchange; (ii) a quota of 25% of produced hydrocarbon is addressed to domestic market; and (iii) there are restrictive foreign workers quota, limiting it from 5 to 10% of the workforce.

- The special legal and contractual regime applicable to the Rovuma Basin Liquefied Natural Gas Project defines the Local Content requirements to be observed by petroleum companies in Mozambique. The Article 10 of the Decree-Law No. 2/2014, for example, establishes preference in contracting the supply of goods and services to national companies, owned by Mozambican citizens or legal entities.

ANGOLA

Local Content is one of the objectives set out in the Angolan government's National Development Plan (2018-2022), and is also supported by Law No. 10/04 (Petroleum Activities Law), which determines that licensees, the National Concessionaire, its associates, and all entities that collaborate with them in the execution of petroleum operations, must cooperate with government authorities in actions to promote the country's economic and social development, as well as acquire domestically produced materials, equipment, and consumer goods, and contract service providers that provide services identical to those available on the international market.

In this context, **Presidential Decree No. 271/2020** was published, establishing the legal regime of Local Content in the O&G sector. The rule extends to all entities that collaborate in the execution of the operations, as well as to Angolan companies and companies under Angolan law that provide services and supply goods to the sector. In addition, it establishes three regimes for the acquisition of goods and services:

- **Exclusivity:** goods and services (the more basic and low-tech types of goods and services) are exclusively reserved for Angolan Commercial Companies ("SCA") (i.e. companies whose share capital is totally owned by Angolans). Non-Angolan contractors are only allowed to provide services under this regime if subcontracted by an Angolan Company.
- **Preference:** goods and services (more sophisticated goods and services) can be performed by non-Angolan (partially or totally) owned contractors, provided that they are registered as a local law company in Angola ("SCDA"). However, SCA contractors hold a preemptive right in the event that their quoted price does not exceed 10% of the price quoted by a SCDA contractor.
- **Competition:** goods and services not included in the above regimes (which require both heavy capital investment and high levels of specialized know-how) may be performed by any contractor, either SCA, SCDA or foreigner, on a competitive basis.

It is up to the National Concessionaire, after hearing the Competition Regulatory Authority, to approve the lists of goods and services subject to the exclusivity and preference regime, as well as to carry out the registration and certification of Angolan companies and companies under Angolan law and create the methodology for measuring the local content index.

The Presidential Decree No. 271/2020 also creates obligations regarding the elaboration and submission of documentation, including (i) annual local content plan, (ii) annual human resources development plan, (iii) annual balance sheet of the development and human resources plan, (iv) Program Contract, (v) investment plan, and (vi) list of expected contracting for each quarter.

SÃO TOMÉ AND PRÍNCIPE

São Tomé and Príncipe ("STP") sets nationality as its main criteria. Local companies have the right of preference regarding the award of participating interests and provision of services and goods contracts, as well as local Goods and Services that are identical to those abroad, as long as the prices are not 10% higher than the imported ones.

Additionally, the country has social responsibility projects which are financed by certain fixed amounts on the exploration and production phase payable by concessionaires.



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