

Brazil Round 1

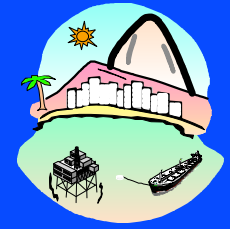


Government Take Under the Oil Law

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Government Take Under the Oil Law



- **Signature Bonus**
- **Royalties**
- **Special Participation Fee**
- **Occupation or Retention Payments**



Signature Bonus



- Amount included in bid to obtain the Concession
- Payable in full to ANP upon signature of the Concession Agreement
- Minimum for each Concession as stated in Initial Tender Protocol to be confirmed by ANP in Final Tender Protocol ("*Edital*")



Royalties - Rate



- Applies on a field by field basis to the gross value of hydrocarbon production from the field
- Rate for each Concession will be 10%, unless otherwise specified in the Final Tender Protocol
 - **ANP considering alternative structures for rate reduction**
- Rate structure for each Block will be specified in Final Tender Protocol
- Rate structure will apply for life of Concession to all fields in Block



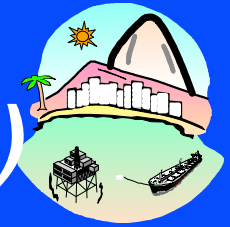
Royalties - Volumes



- **Royalty applies to total volumes of oil and gas:**
 - **Measured at metering point(s) provided in Development Plan for the field**
 - **Consumed as fuel in same-field operations**
 - **Lost before metering**
 - **Flared without prior ANP authorization or immediate post-flaring justification accepted by ANP**



Royalties - Volumes (*Continued*)



- Volumes of gas excluded from royalty calculation:
 - **Gas used for gas lift**
 - **Gas reinjected in the same field**
 - Gas reinjected in a different field subject to Royalty, but second field can deduct volumes in calculating own Royalties
 - **Gas flared in accordance with industry practice and approved by ANP**



Royalties - Oil Reference Price



- Monthly oil production sold valued at higher of:
 - **Weighted average actual sales prices during month, and**
 - **Minimum prices determined by ANP**
- Monthly oil production transferred to producer's own facilities valued at minimum price



Royalties - Oil Reference Price (continued)



- Actual sales prices
 - **First sale to another legal entity is used for determining price for each transaction (sale may be to an affiliate if at arm's length)**
 - **Price excludes any taxes**
 - **Excludes "transportation" (i.e., common carrier) costs - even to an affiliate - if properly documented and at arm's length, but not "transfer" costs (i.e., costs of transportation by producer using own facilities)**
 - **Foreign currency prices converted at official Central Bank rate for the date of sale**



Royalties - Oil Reference Price (Continued)



- **Minimum Prices Determined by ANP**
 - **Based on standard basket of up to 4 types of similar crudes proposed by Concessionaire**
 - Submit to ANP at least 20 days before start of production, with information on physical, chemical and competitive characteristics
 - ANP has 10 days to approve proposed basket or suggest replacement crudes
 - Basket can be changed over time on initiative of Concessionaire or ANP
 - **No adjustment for transportation and handling costs either to or from Brazil or inside Brazil**
 - Use straight FOB prices as reported in Platt's
 - **If no proposal from Concessionaire, ANP can establish minimum price on its own**
 - Currently *Portaria 155* covers this situation



Royalties - Oil Reference Price (Continued)



- **Portaria 155/98** of Oct 21, 1998 establishes the following minimum price calculation:
 - $P_{\text{Specified Brazilian crude}} = P_{\text{Brent crude}} \pm \text{Differential, in U.S. Dollars}$
 - Dollar price converted into *reais* at monthly average of daily rates published by Central Bank
 - Minimum price is calculated as monthly average of daily marker prices for Brent and distillates as reported in Platt's



Royalties - Oil Reference Price (Continued)



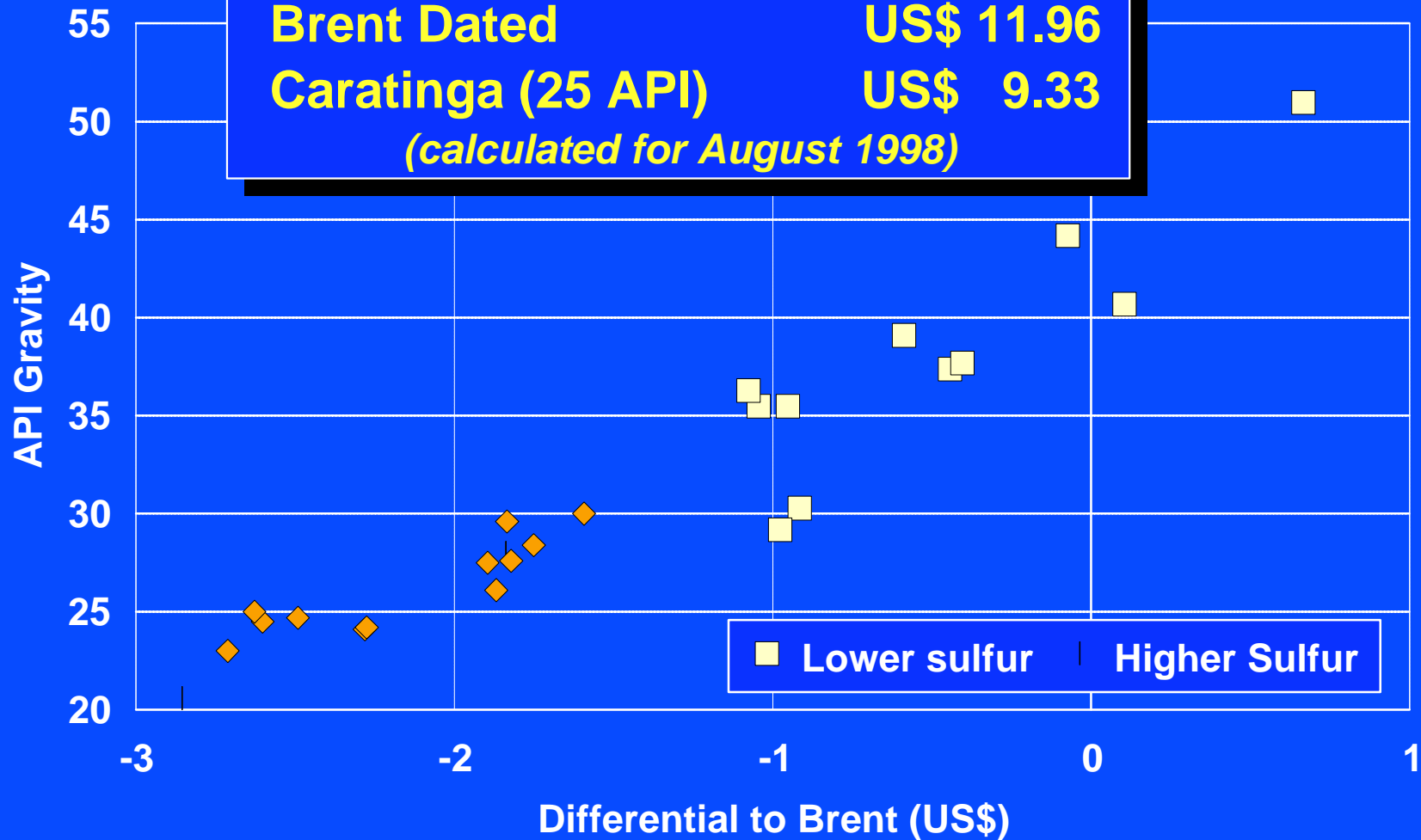
- **Differential calculation:**
 - **Value of three types of distillates from specified Brazilian crude, based on Rotterdam price for each distillate**
 - MINUS**
 - **Value of the same distillates from Brent, also based on Rotterdam prices**
 - **Difference applied to price of Brent crude to obtain Minimum Price of Brazilian crude.**
- **Distillates used:**
 - **Regular unleaded - (light distillates)**
 - **Gasoil (0.2% or EN590) - (middle distillates)**
 - **Fuel oil 1% and 3% - (residuals)**



Royalties - Oil Reference Price - Example of Differential Calculation

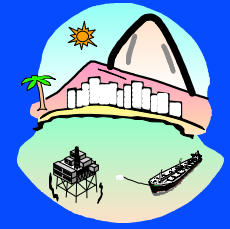


Price Calculation per Portaria 155
Brent Dated US\$ 11.96
Caratinga (25 API) US\$ 9.33
(calculated for August 1998)





Royalties - Oil Reference Price (Continued)



- Each month, ANP will publish minimum prices for production in each Brazilian field in the prior month
- Recalculated monthly as the arithmetic mean of daily prices reported in Platt's



Royalties - Gas Reference Price



- If any gas sold, monthly gas production valued based on weighted average of actual sales prices during month
 - **First sale to another legal entity is used for determining price for each transaction (sale may be to an affiliate if at arm's length)**
 - **Price excludes any taxes**
 - **Excludes "transportation" (i.e., common carrier) costs - even to an affiliate - if properly documented and at arm's length, but not "transfer" costs (i.e., costs of transportation by producer using own facilities)**



Royalties - Gas *Reference Price* (*Continued*)



- If no gas sold, valuation of gas as provided in *Portaria 162/98*:
 - **Price for gas used in operations is zero if**
 - No gas is transferred for any purpose other than carrying out operations within field where produced and
 - No market for gas exists due to its quantity or quality or lack of access to a market (including due to lack of infrastructure)
 - **All other gas subject to royalty is valued at price set by Ministry of Finance as maximum price for gas used as fuel (currently R\$100.3624/Mm³ for gas at 9400 kCal/m³ ~ 1056 MBtu/Mcf)**
 - Gas price currently indexed on price of 1A fuel oil



Royalties - Other Provisions



- Reports on production (by field and well) and sales prices for each month due by 15th of following month
- Royalties on production for each month payable by last business day of following month to *Secretaria do Tesouro Nacional* (Secretariat of the National Treasury)
- Documentation of payment to be delivered to ANP within five business days after payment
- Standard report form provided by ANP



Special Participation ("SP")



- Payable quarterly on net revenues from fields that achieve substantial production volumes
- No SP due unless and until threshold volumes achieved
- Standard reporting form
 - **Simplified when no SP due**



SP - General



- Production and expenses ring-fenced on field-by-field basis
- Rates vary according to criteria set forth in Presidential Decree No. 2705, Aug 3, 1998
 - **Volume of quarterly production**
 - **Location of field**
 - Onshore
 - Offshore \leq 400 meters
 - Offshore $>$ 400 meters
 - Determination of depth of each field within a Concession Area to be based on majority of surface area covered by field
 - **Years in production**
 - Threshold volume declines with production years
 - 1, 2, and 3 years
 - 4 years and over



SP - Example of Rate Table



Year 4 and beyond, water over 400 meters

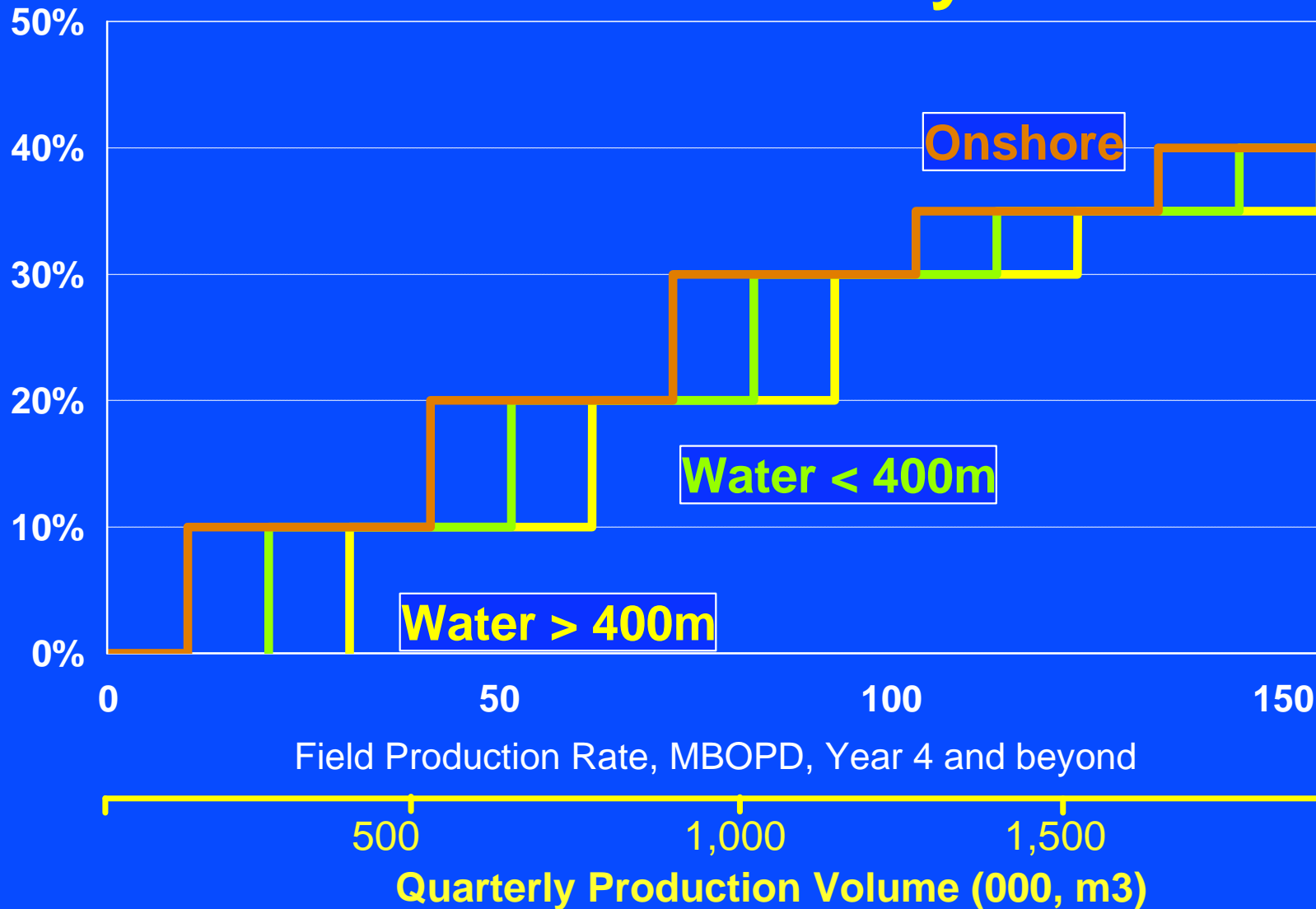
Verified Quarterly Production Volume (in 000 cubic meters of oil equivalent)	Portion to be deducted from the Quarterly Net Revenue (in reais)	Rate (%)
Up to 450	-	exempt
Over 450 - up to 900	$450 \times \text{QNR} / \text{QPV}$	10
Over 900 - up to 1,350	$875 \times \text{QNR} / \text{QPV}$	20
Over 1,350 - up to 1,800	$900 \times \text{QNR} / \text{QPV}$	30
Over 1,800 - up to 2,250	$360 / 0.35 \times \text{QNR} / \text{QPV}$	35
Over 2,250	$1,181.25 \times \text{QNR} / \text{QPV}$	40



SP - Example of Location Dependency (Year 4+)



Rate structure varies by location



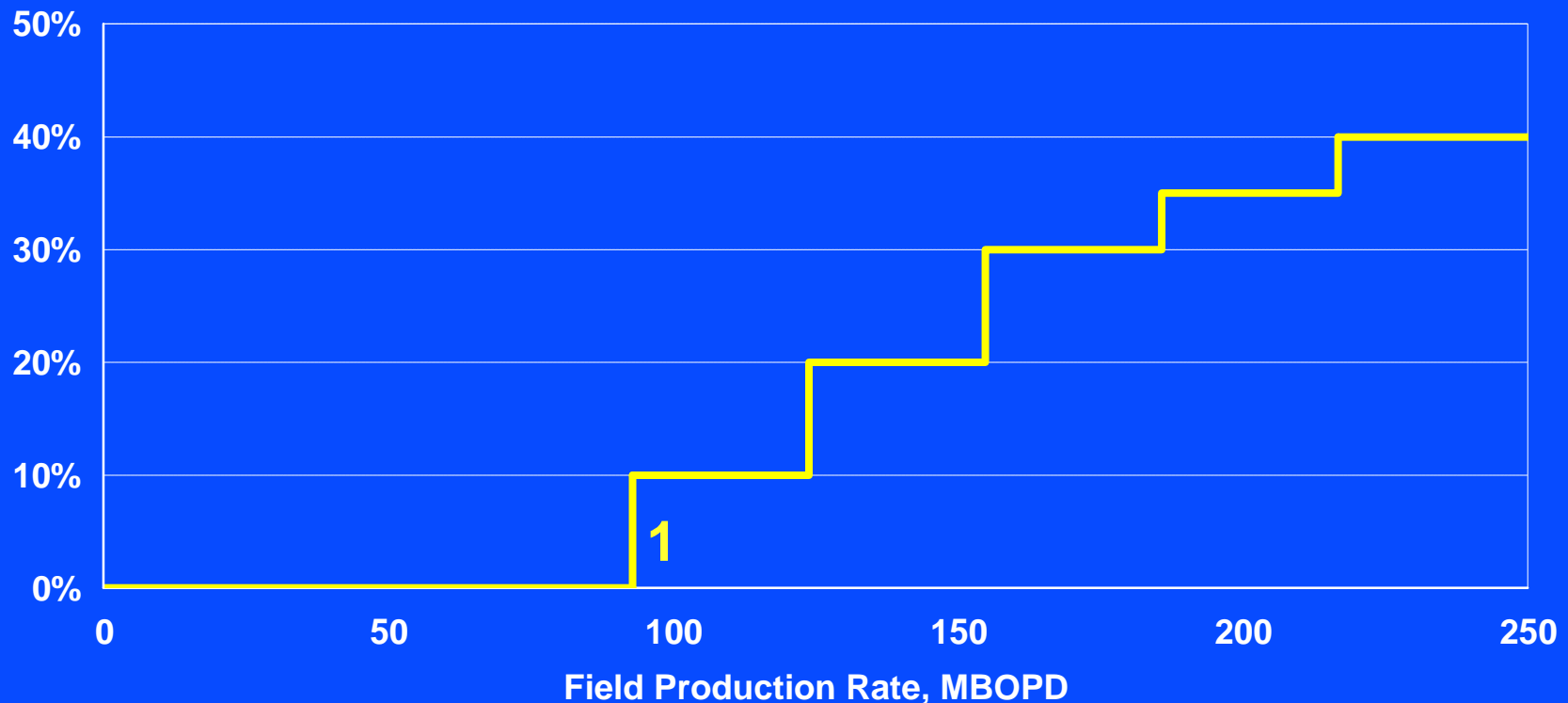


SP - Example of Time Dependency - Deep Water (>400m) - Year 1



Threshold varies for years 1, 2, 3, 4 and beyond

Rate applicable %



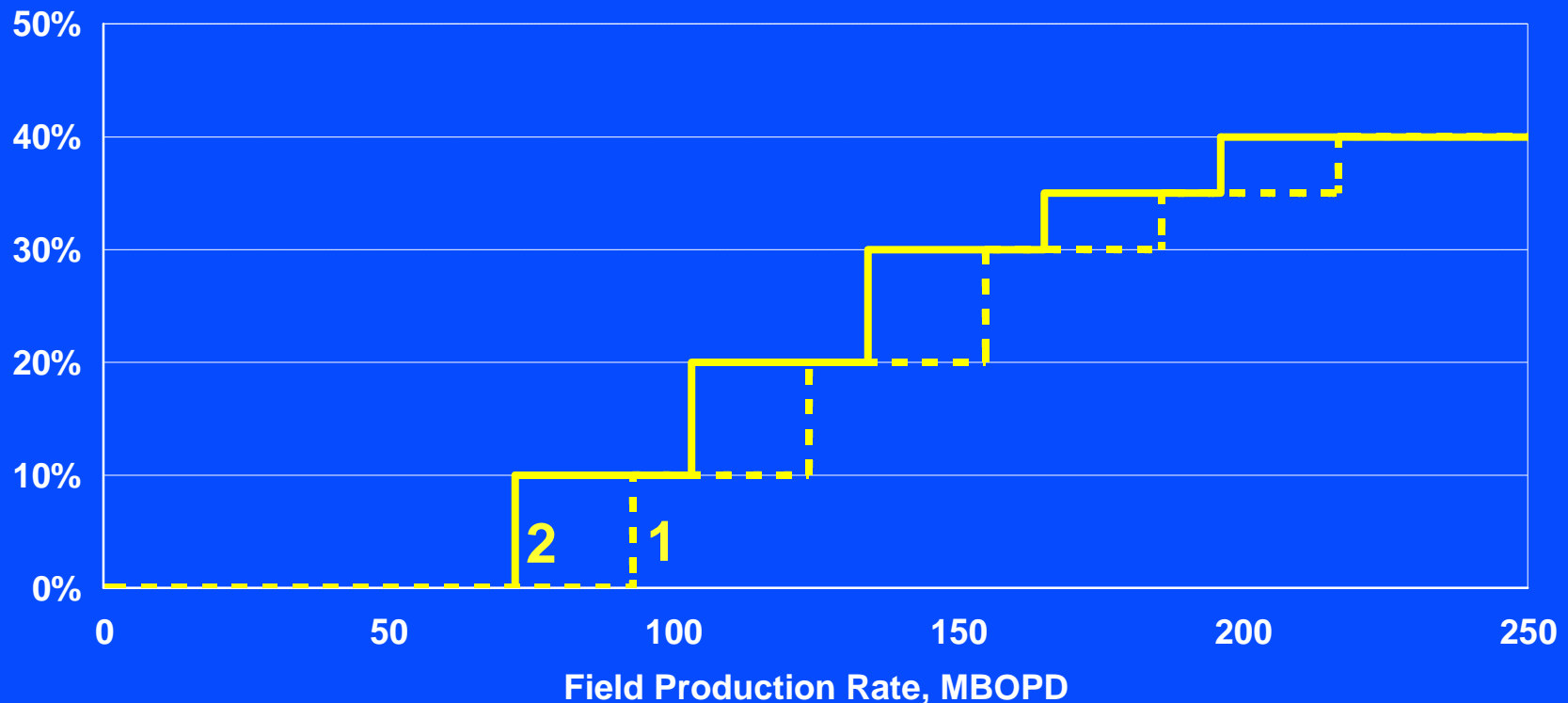


SP - Example of Time Dependency - Deep Water (>400m) - Year 2



Threshold varies for years 1, 2, 3, 4 and beyond

Rate applicable %



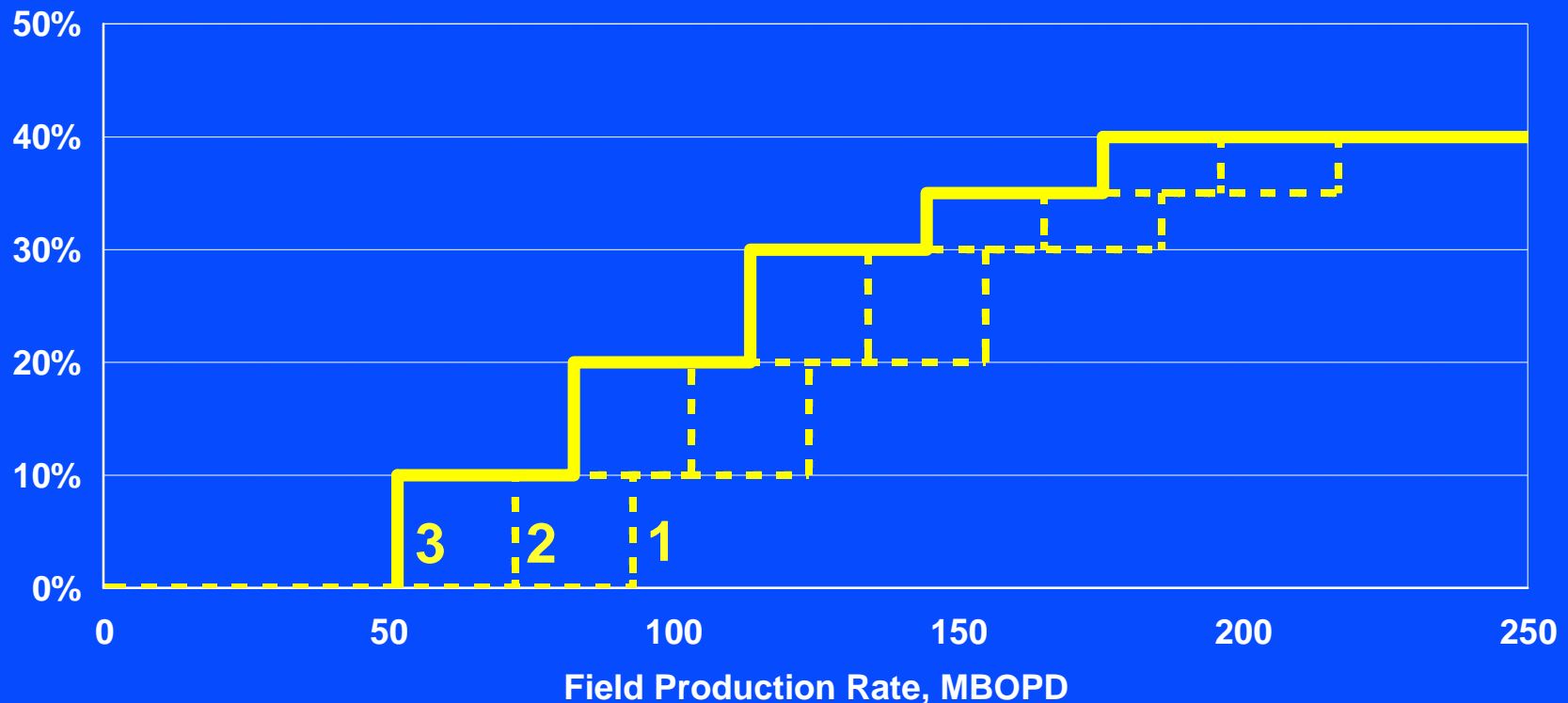


SP - Example of Time Dependency - Deep Water (>400m) - Year 3



Threshold varies for years 1, 2, 3, 4 and beyond

Rate applicable %



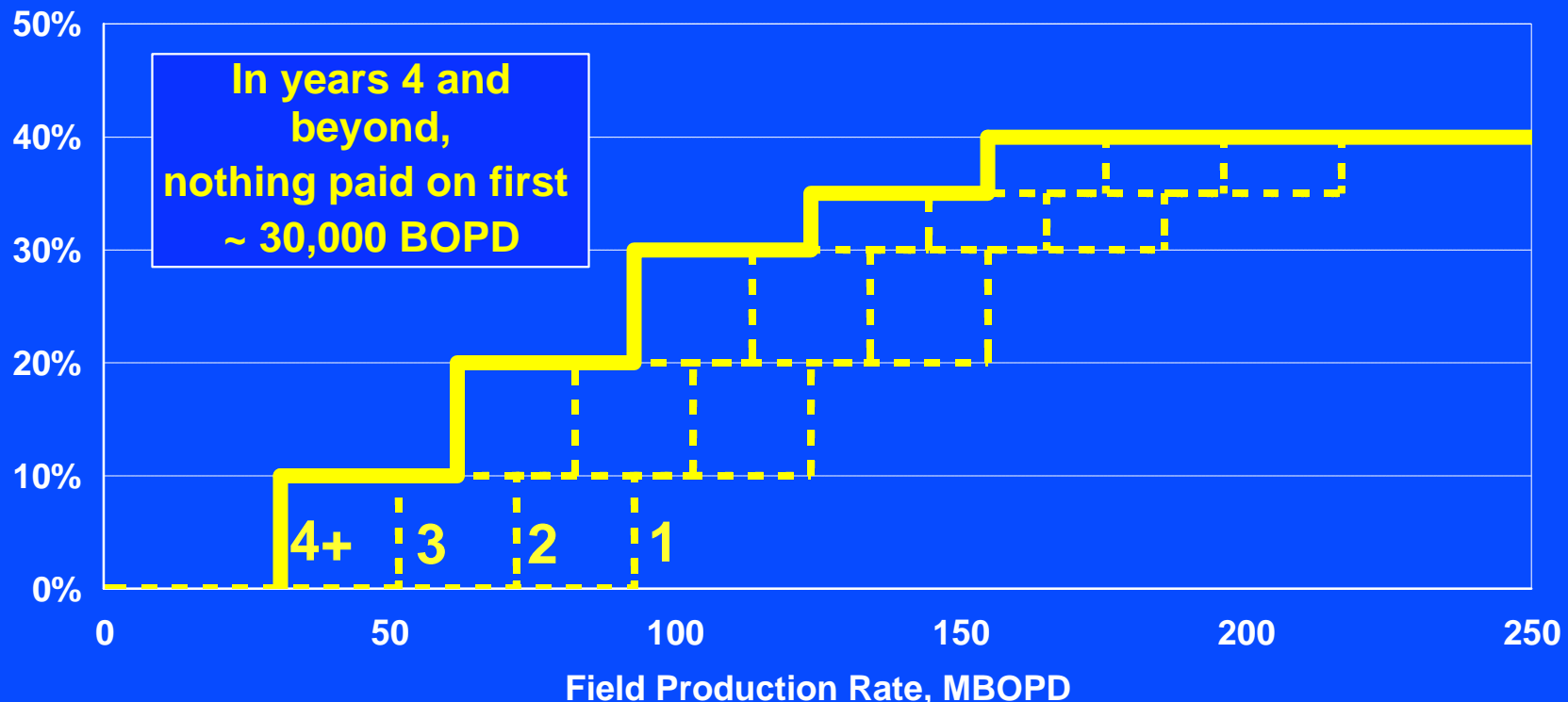


SP - Example of Time Dependency - Deep Water (>400m) - Year 4



Threshold varies for years 1, 2, 3, 4 and beyond

Rate applicable %



In years 4 and beyond, 40% rate only applies to production in excess of ~ 150,000 BOPD (> 220,000 BOPD in year 1)

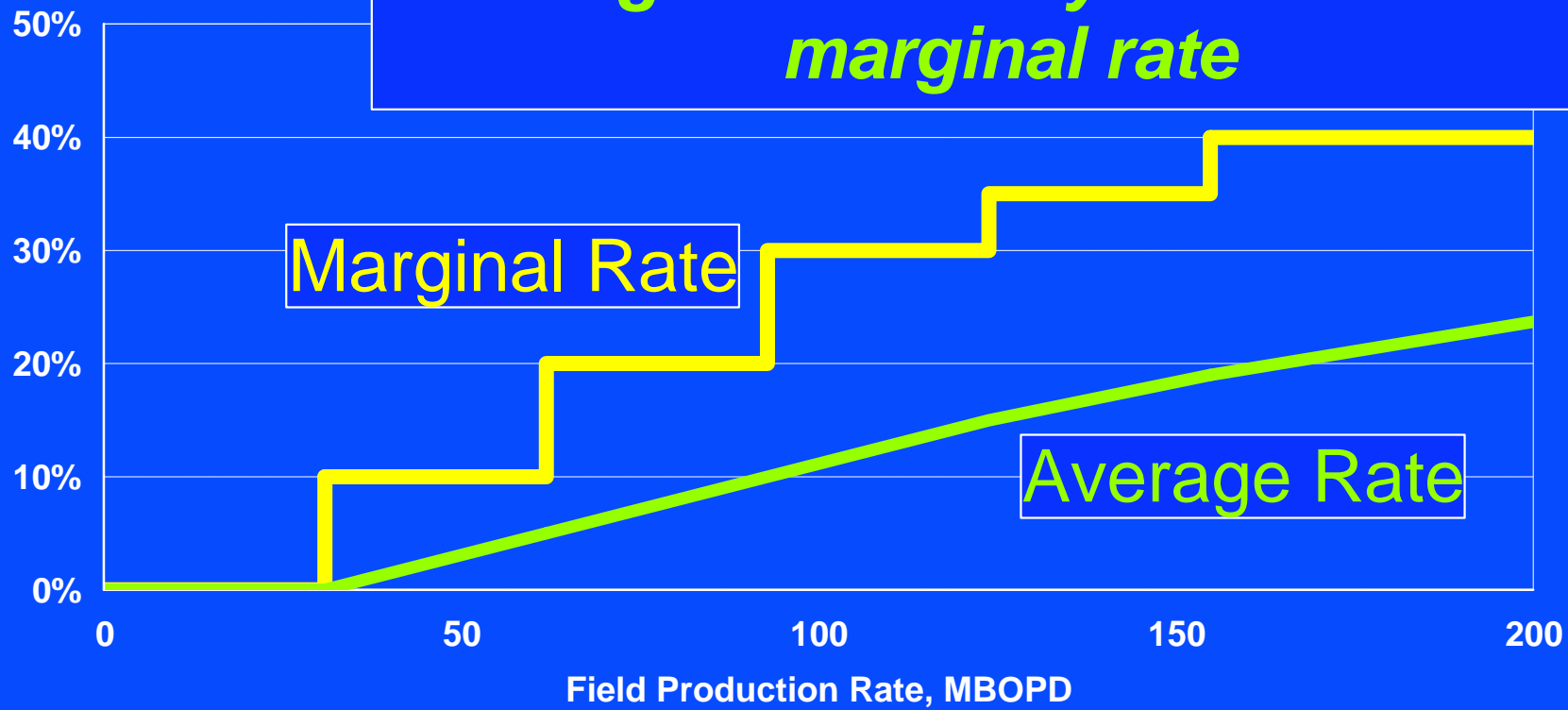


SP - Average Rate Lower than Marginal Rate



Rates apply to production tiers
average rate is very different from marginal rate

% of Net Revenue





SP - Calculation - Gross Revenues



- **Gross revenues for field determined based on same volumes and valuations used for Royalty, except**
- **Oil and gas volumes used in operations, lost before metering or flared without authorization not included for purposes of SP**



SP - Deductions



- Detailed rules set forth in *Portaria* 10/99 (Jan. 13, 1999)
- Signature bonus - 100% in first quarter
 - ANP considering allowing Concessionaire either to take deduction in a later quarter or to amortize bonus over time
- Certain fees and taxes on E&P activities
 - Royalties
 - Occupation and retention fees
 - Landowner fees
 - 1% research and development investment
- Not deductible: social charges and contributions, income and withholding taxes and taxes on sales of oil and gas

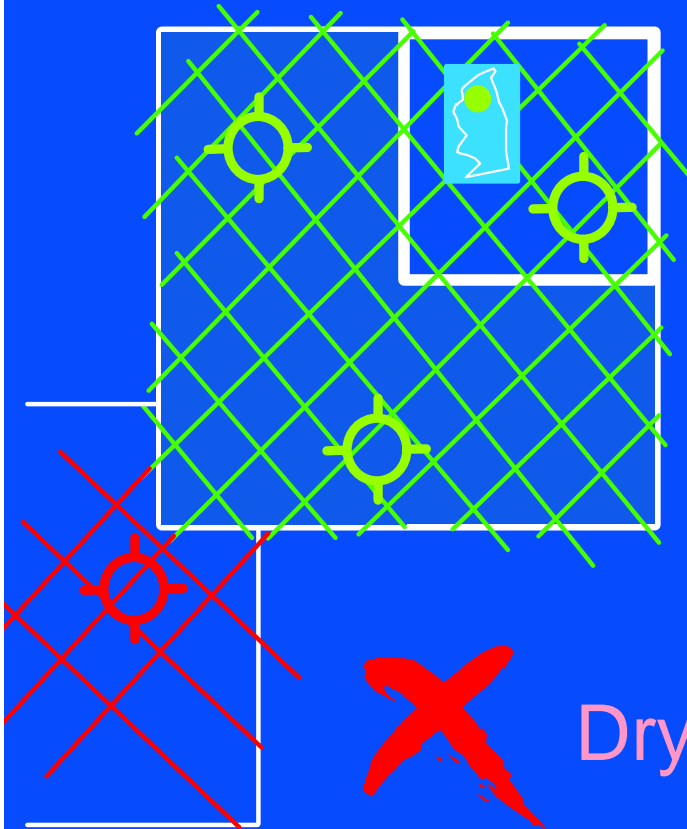
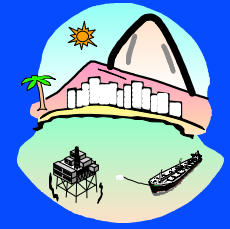


SP - Deductions (*Continued*)



- Pre-production expenses - 100% in first quarter of production
 - ANP considering allowing Concessionaire either to deduct in a later quarter or to amortize over time
- Types of Expense
 - Exploration and appraisal expenses in field
 - Exploration and appraisal expenses shared with other fields in Concession Area (including dry wells)
 - To be applied to first field for which Development Plan approved after expense incurred
 - ANP considering possibility for Concessionaire to allocate shared exploration expenses to different fields at own discretion
 - Other expenses, as applicable, described below under "Production Expenses"

SP - Deductions (Continued) - Exploration Costs



Discovery wells for field



All seismic in original
Area



Dry holes in original
Area



Dry holes from other licenses



Regional seismic (outside Area)



SP - Deductions (*Continued*)



- **Production expenses of field - as incurred**
 - **Direct labor and materials**
 - **Development wells**
 - **Capital equipment - depreciated on same basis as Brazilian income tax**
 - Accelerated depreciation for Brazilian equipment for SP
 - **Fees for services (including services provided by headquarters or affiliates, provided at arm's length) directly related to field**
 - **Costs of "transfer" in private facility (but not "transportation" in common carrier)**
 - **Interest on qualifying loans from third parties**
 - **Foreign exchange losses**
 - Gains added to net revenues
 - **Allocable share of expenses applicable to more than one field (inside or outside Development Area)**
 - **Provision for abandonment (straight line over remaining life)**
 - **Landowner compensation and land occupancy payments**



SP Deductions - (*Continued*)



- Foreign exchange gains and losses
 - Calculated on the basis of changes in value of financial liabilities denominated in foreign currency
 - When *real* falls in value relative to foreign currency, holder of liability experiences deductible loss
 - When foreign currency falls in value relative to *real*, holder of liability experiences gain that is added to net revenues
- Does not apply, for SP purposes, to financial assets denominated in foreign currency



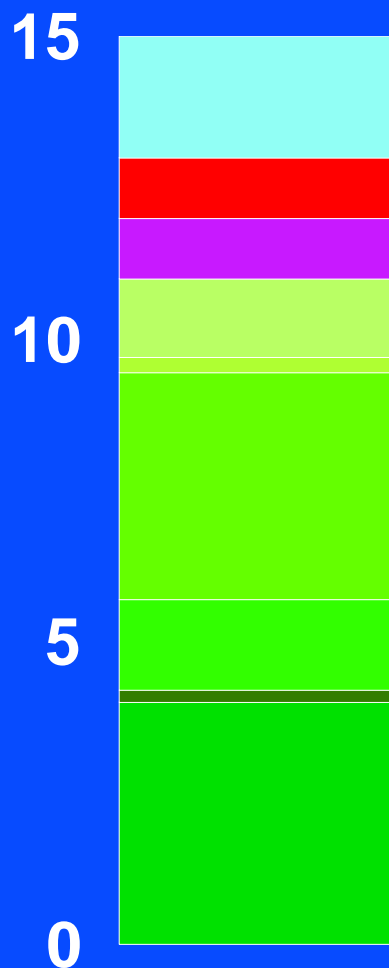
SP - Deductions (Continued)



- Nondeductible expenses
 - No deduction for general corporate overheads
 - Unless company's business only involves field
 - Then can deduct all company's expenses
- Net "losses" can be carried forward indefinitely



SP - Net Revenues - Example of Calculation



Net Production Revenue

Loss carryforward

Bonus

Allowable exploration expense

Abandonment provision

Depreciation and amortization

Royalty, fees and taxes

Occupation Fees

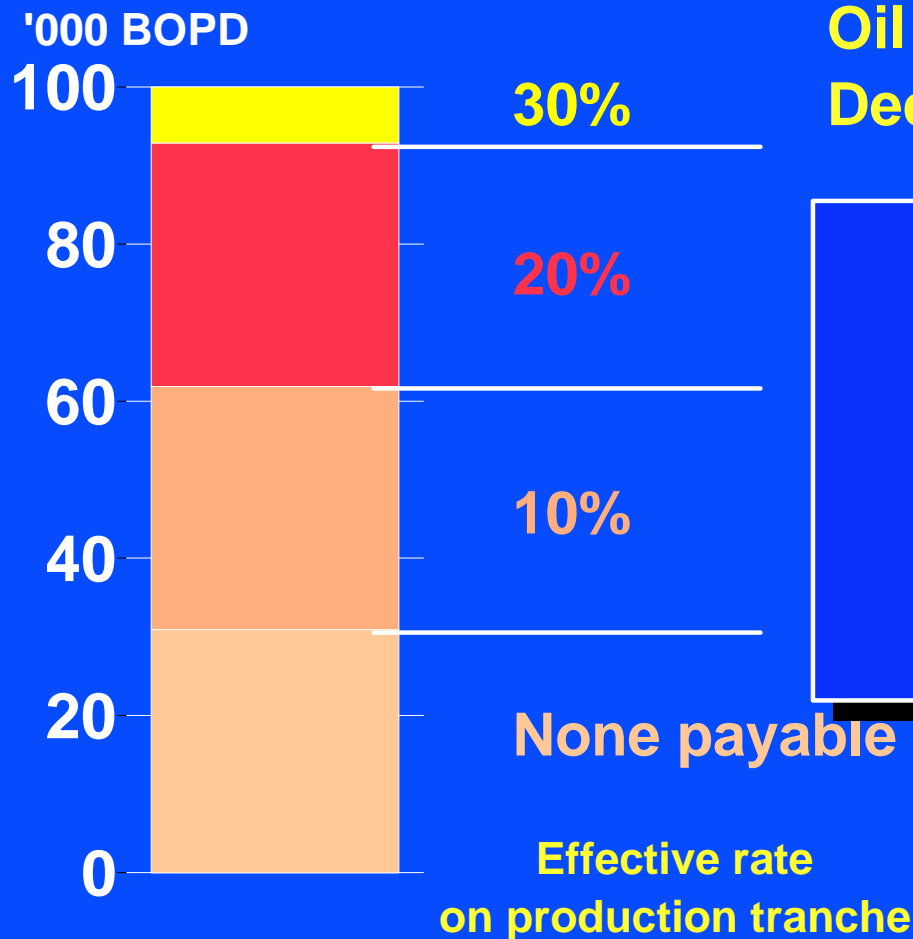
Operating expense



SP - Illustration of Impact



Amount subject to Special Participation



Example - Year 4+, 500m water
Production - 100,000 BOPD
Oil price - US\$ 15 / Bbl
Deductions total - US\$ 11 / Bbl

EXAMPLE
Effective average rate
~ 11.5%
or
~ US\$ 0.45 / Bbl

Computations are quarterly
Actual volumes calculated in cubic meters



Occupation or Retention Payments



- Annual charge based on surface area subject to Concession Agreement
 - **Payment per square kilometer and initial surface area stated in Final Tender Protocol**
 - **Will be adjusted automatically for relinquishments and areas with respect to which development period on production phase begins**
- Payments with respect to each year due on January 15 of following year



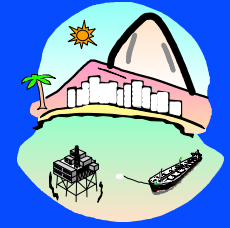
Occupation or Retention Payments (*Continued*)



- Rates per square kilometer vary depending on phase
 - **First exploration period (as set forth in FTP)**
 - Decree 2705/98 - between R\$10.00 and R\$500.00 per square kilometer
 - **Second and third exploration periods (twice rate for first exploration period)**
 - **Development period of production phase**
 - R\$20.00 - R\$1,000.00 per square kilometer
 - **Production phase**
 - R\$100.00 - R\$5,000.00 per square kilometer
 - Rates are 1998 rates before indexation



Occupation or Retention Payments (*Continued*)



- Rates indexed on Brazilian inflation rate as reported in *Índice Geral de Preços - Disponibilidade Interna (IGP-DI)*
 - Published in *Conjuntura Econômica*
 - Available from *Fundação Getúlio Vargas*
- Payments will be prorated based on actual days elapsed for partial years and transitions between phases during a year

Brazil Round 1



**Landowners'
Compensation**



Landowners' Compensation



- Applies to onshore Areas only
- Landowners with production wells on their land entitled to compensation based on total value of production from wellheads located on their property
 - **Injection wells do not give right to compensation**
- Valuation of oil and gas same as for Royalty
 - **For producing wells sharing common meter, hydrocarbon value allocated based on relative volumes**



Landowners' Compensation



- Petroleum Law says rate may be 0.5%-1.0%; *Portaria* 143/98 (Sept. 1998) provides for a rate of 1%
- Payment mechanism to be established directly between companies and landowners
- Fee to be paid monthly



Eminent Domain



- Owners of properties used by Concessionaires also entitled to payment for eminent domain (rights of way, easements, etc.)
- Eminent domain payments are only compensation to be received by owners of properties on which non-producing wellheads are located
- Costs of eminent domain for sole account of Concessionaire
 - **Deductible for income tax and SP purposes**