

UNDERSTANDING THE TRANSFER OF RIGHTS SURPLUS



INVEST
IN BRASIL



E-book

“Understanding the Transfer of Rights Surplus”

About the E-book

This e-book was produced for international companies to better understand details about the developments on the 2021 Second Transfer of Rights Surplus Production Sharing Bidding Round offered by National Agency of Petroleum, Natural Gas and Biofuels (ANP) regarding the development areas of Sépia and Atapu located in the pre-salt layer of the Santos Basin.

Several governmental institutions are involved in the initiative: Ministry of Mines and Energy, Ministry of Foreign Affairs, Brazilian Trade and Investment Promotion Agency (Apex-Brasil), ANP, Pré Sal Petróleo (PPSA) and Empresa de Pesquisa Energética (EPE). This content was produced by Pré-sal Petróleo, PPSA, which institutional mission is to mobilize all its expertise and management capacity to provide the Union with the best results under Production Sharing Agreements in the pre-salt exploration and production.

Introduction

Since 2014, with the publication of CNPE Resolution No. 01/2014, the Transfer of Rights (ToR) Surplus has been discussed within the Federal Government. In 2019, the subject was addressed with the first auction of the Transfer of Rights Surplus, under the Production Sharing Contract (PSC).

At the time, among the four offered blocks, those of Búzios and Itapu were auctioned, raising R\$ 69.9 billion in Signature Bonuses only. The remaining areas, Sépia and Atapu, did not receive any bids, and will be offered in a new auction in December 2021.

This e-book seeks to clarify the main queries on the subject, in a simple and effective way.

What are the Concession and the Production Sharing Regimes?

The Concession and Production Sharing are legal-fiscal regimes for the exploration and production of oil and natural gas. The main difference between them is the degree of State interference in operations and how the ownership of the hydrocarbons is originally appropriated.

Under the Brazilian Concession regime, all oil and natural gas produced are originally acquired by the Concession holder. The State does not take part in the operations, but regulates and supervises them. Oil companies acquire the blocks in auctions promoted by The Brazilian National Agency of Petroleum, Natural Gas and Biofuels (ANP), offering weighted amounts of Signature Bonus and Minimum Exploratory Program. The Government Take comprises taxation, royalties and a specific contribution named special participation.

In the Brazilian Production Sharing regime, the oil and natural gas produced are originally shared between the State and the oil companies. The State participates, without investing or taking risk, in the activities of exploration and production, in addition to regulating and supervising them. In the bidding for the area offer, the Signature Bonus is fixed, and the bidder who presents the highest percentage of profit oil to the Federal Government is the winner. The Government Take comprises taxation, royalties and the commercialization of the portion of the profit oil to which the Federal Government is entitled.

What is Transfer of Rights (ToR)?

As defined in the contract, “Transfer of Rights: means the legal business through which the Federal Government transfers, onerously, to the Assignee, the rights for the research and production of Petroleum and Natural Gas, under Law No. 12,276 of 2010.”

In other words, the Transfer of Rights is a legal-fiscal regime that, different from usual bidding, the Federal Government directly granted Petrobras the oil and natural gas exploration and production rights in seven blocks located in the pre-salt area. These rights, however, are limited to a volume of five billion barrels of equivalent recoverable oil (boe). In return, Petrobras had to pay, preferably in Federal Government debt securities an amount initially expected at R\$ 74.81 billion³.

The original blocks assigned to Petrobras and their respective volumes were as follows:

BLOCKS	FIELDS	TRANSFER OF RIGHTS VOLUMES (MMBOE)	
		INITIALLY EXPECTED	REVISED
Florim	Itaipu	467	350
Franco	Búzios	3058	3150
Sul de Guará	Sul de Sapinhoá	319	0
Entorno de Iara	Atapu		550
	Norte de Berbigão e Sul de Berbigão	600	80
	Norte de Sururu e Sul de Sururu		20
Sul de Tupi	Sul de Tupi	128	350
Nordeste de Tupi	Sépia	428	500
Peroba	–	–	–
	TOTAL	5000	5000

The Transfer of Rights contract, signed in September 2010, expires in 40 years with a possible five-year extension. The Parties are the Federal Government, represented by the MME and the Ministry of Economy (at the time it was signed, Ministry of Finance) and Petrobras, as Assignee.

What means the Transfer of Rights (ToR) Surplus?

Based on the acquisition of new reservoir data, the studies carried out by Petrobras and supervised by ANP in the ToR blocks, the existence of a volume substantially higher than the five billion barrels of equivalent recoverable oil (boe) was estimated. This additional volume is now referred as the ToR Surplus.

However, Law No. 12,276/2010 did not address how to proceed in case the recoverable volume was higher than five billion boe transferred to Petrobras. This caused the unusual situation of having reservoirs of very high productivity and profitability whose production rights were limited to a significantly lower volume than those accumulated therein .

It was necessary, then, to create regulatory mechanisms that would enable the production of the Transfer of Rights Surplus, without any loss, however, to the rights acquired by Petrobras with the ToR Contract.

Why are the Transfer of Rights Surplus contracted under the Production Sharing regime?

The Law No. 12,351/2010, in its Article 3, establishes that the exploration and production of oil and natural gas in the pre-salt polygon and strategic areas should be contracted under the Production Sharing regime.

Of course, the exploration and production contracts related to the areas that, at the time of the publication of Law No. 12,351/2010, were already contracted under Concession regime, were preserved. In addition, the areas already granted to Petrobras under the ToR regime by Law No. 12,276/2010 and the ToR contract, signed in September 2010, were maintained.

Thus, the ToR Surplus volumes must be contracted under the Production Sharing regime, since they are located in the pre-salt polygon, in the same reservoirs in which the volumes contracted under Transfer of Rights regime are located.

So, will the Transfer of Rights Surplus be produced in the same geographical area in which the five billion barrels of oil equivalent were contracted under Transfer of Rights?

Yes. Production will take place in the same area, sharing all development and production infrastructure. It is a new format, adapted to the uniqueness of the Transfer of Rights regime, to allow the joint production in the same area, but with different exploration and production

contracts (Transfer of Rights and Production Sharing). This scenario led to the creation of a new legal institute, called Co-participation. The Co-participation Agreement is defined by MME Ordinance No. 265/2019, as “the agreement between the contractor of the PSC of the ToR Surplus, the Assignee of the ToR contract and PPSA, as the Consenting Intervener, for the unified development and production in the Co-participated Area.”

And how does Co-participation work?

Just like the unitization, Co-participation aims at the production in reservoirs which are the subject of more than one contract. In order to avoid the competitive production between the Assignee and the PSC contractors, Co-participation unifies their operations, electing a single Operator to execute them.

Although Co-participation has some similarities with unitization, they should not be confused. For example, there is no extension of the Co-participated area to another area, which is the trigger of the unitization process (Law No. 12,351/2010, art. 33, caput), since both contracts (Transfer of Rights and Production Sharing) have the same geographical limit. Moreover, as the volume to be appropriated under the ToR regime is fixed, the Tract participations of the ToR contract and the PSC in the Co-Participated area is based on the recoverable volume of equivalent oil, and PPSA participates in the Co-Participation agreement as Consenting Intervener.

Co-participation can be understood as a kind of unitization in time: the ToR Surplus volumes, which would be produced after the production of the ToR volumes, are produced simultaneously.

What are Tract Participations and how are they calculated?

The Tract Participations correspond to the percentage of the ToR Contract and the PSC in the rights and obligations of the Co-participated Area. That is, both the original appropriation from the joint production (co-participated), and the payment of investments and development costs of the Co-participated area are divided among the contracts, based on the calculated Tract Participations.

To define the Tract Participations, the parties perform Geological and Geophysical (G&G) studies and petroleum engineering studies using a common database to estimate the recoverable oil and natural gas volumes. The Tract Participations are calculated based on the recoverable volume (volume of oil and natural gas) to be produced along the Co-participation Agreement, considering that the volume contracted under the ToR is already known. The same reasoning applies to the division of the expenditures among the contracts.

Why is PPSA Consenting Intervener in Co-participation Agreements?

PPSA is not a Party in the Production Sharing contracts, as the Federal Government, represented by it, has no rights or obligations under this instrument. That is, the Federal Government's work interest is zero. In the Co-participation, this condition is transferred by the PSC of the ToR Surplus to the Co-Participation Agreement, so that **there is also no PPSA work interest**.

Since it does not have participation in the Co-participation Agreements, PPSA, the representative of the Federal Government, would not be entitled to vote on the Operational Committee of the consortia that compose this Agreement. However, the Federal Government has rights in the Co-participation Agreements, since it has a share of the hydrocarbon surplus.

Therefore, PPSA's Consenting Intervener position in the Co-participation Agreements comprises the lack of Federal Government participation in rights and obligations and the public interest involved in Co-participation. Representing the Federal Government, PPSA participates (intervenes) in all stages of the Co-Participation Agreements negotiations and agrees or not with its terms, since it has a legitimate and undeniable interest in its outcome.

Do the initially negotiated Tract Participations exist for the entire duration of the Co-Participation Agreements?

Not necessarily. Considering the conditions and frequency defined in the Co-participation Agreement, Re-determinations will be carried out, to review the previously agreed Tract Participations. With the advance of the geological knowledge of the Co-participated Area and the results and information obtained during production, the Parties and Consenting Intervener define a new common database and renegotiate the Tract Participations. If these shares are changed, the expenditures and volumes are equalized considering what has already incurred.

What else is in the Co-Participation Agreement?

Art. 3 of Ordinance MME 265/2019 defines the minimum information that must be contained in the Co-participation Agreements:

- **Identification of the Co-participated Area;**
- **Definition of the Operator of the Co-participated Area**
- **Division of the rights and obligations of the Parties involving the Federal Government and the public interest**

- **Tract Participation and work interests of the Parties**
- **Possibilities for changes in the Tract Participations (Re-determinations)**
- **Obligations related to the payment of government take and revenues**
- **Local Content Rules**
- **Development Plan for the Co-participated area**
- **Expiration date**
- **Procedures for the proposition of Sole Risk Operations**
- **Amount and method of payment of the Compensation**
- **Conflict resolution rules and mechanisms**

What is the Compensation due to Petrobras?

The pre-existence of a contract under the ToR regime, in an area on which a PSC will be simultaneously active, comprises rights of the Petrobras Assignee, that cannot be (and have not been) neglected in the new regulation. Petrobras, as a Assignee of the volumes contracted under ToR, has already made relevant investments in studies, tests, and infrastructure, which allow the extraction of hydrocarbons from the blocks contracted under ToR much more quickly and efficiently.

Of course, Petrobras, as a Assignee, must be financially compensated, because all investments previously made will be used by the new Contractors under PSC and by the Federal Government itself, which will also have, immediately after the Co-participation Agreement is effective, the right to the original appropriation of a production share.

For this reason, CNPE Resolution No. 02/2019 provided for the payment of a Compensation to Petrobras by the new Contractors under PSC, in return for the partial transfer of assets already acquired, built, or installed by the Assignee under the ToR contract.

But isn't Compensation defined by MME Ordinance No. 213/2019 as the result of Net Present Value 1 (NPV1) – Net Present Value 2 (NPV2)?

No. The Compensation due to Petrobras, as mentioned, is the counterpart for the partial transfer of the assets of Petrobras Assignee. This is how CNPE resolution No. 02/2019 defines it, in its art. 1, item II. The MME Ordinance No. 213/2019 deals with the pricing determination of the Compensation. According to the Ordinance, the assets partially transferred from Petrobras Assignee to the Contractors in PSC shall be paid in accordance with the formula $NPV1 - NPV2$. For the calculation, the following are considered:

- NPV1, which is the prospective net present value of the cash flow related to the production of the volume contracted under ToR without the concomitant production of the ToR Surplus.
- NPV2, which is the prospective net present value of the cash flow related to the production of the volume contracted under ToR, considering the concomitant production of the ToR Surplus volumes, considering the Tract Participations.
- The result of NPV1 – NPV2 (Compensation pricing), which corresponds to the NPV lost by Petrobras Assignee due to the concomitant production of the ToR and the ToR surplus volume. Or it is the decrease in the NPV of the ToR due to the deferral of its production caused by the anticipation of the production of the surplus volume.
- The addition, to the result of the operation NPV1 – NPV2, of the taxes estimate (Income Tax and Social Contribution) incident on the capital gain earned by Petrobras Assignee in the partial transfer of its assets to the Contracted in PSC (gross up).

And why is Compensation recoverable as Cost Oil⁴?

The Cost Oil, in summary, **is the volume of hydrocarbons that correspond to the expenses of the Contractor in exploration and production activities.**

As the Compensation corresponds to the amount paid by the Contractors under PSC to acquire part of the assets of the Assignee, which will be used in joint operations, it is an investment in exploration and production activities, and should therefore be recovered as Cost Oil.

If Petrobras is one of the Contractors under Transfer of Rights Surplus, is there Compensation between Petrobras Contractor and Petrobras Assisnee?

Yes, although there is no financial transaction involving Petrobras and Petrobras of course. It is necessary to differentiate, in this case, Petrobras' position as the Assignee of the ToR Contract and as a Contractor from the ToR Surplus under PSC.

4 Law No. 12,351/2010, art. 2, item II: "Cost Oil: portion of the production of oil, natural gas and other fluid hydrocarbons, required solely in case of commercial discovery, corresponding to the costs and investments made by the contractor in the execution of the activities of exploration, evaluation, development, production and decommissioning of the facilities, subject to limits, deadlines and conditions established in the contract."

The concomitant Production of the ToR and ToR Surplus reduces the NPV of the ToR, regardless of who the Contractors are. Thus, compensation is due even if Petrobras is in both sides of the relationship.

There is certainly no payment from Petrobras to Petrobras, because, in this case, the legal institute of “confusion”⁵ applies (who pays is the same that receives). Nevertheless, the amount corresponding to the Compensation is fully recognized as Cost Oil.

However, on the amount corresponding to the work interest of the Contractor Petrobras in the PSC of the ToR Surplus, there is no gross up related to the taxation of the capital gain of the Assignee, because there is no actual transfer of ownership of Petrobras Contractor assets to Petrobras Assignee.

For the same reasons, even if Petrobras owns 100% of the rights to explore and produce the ToR Surplus under PSC (as is the case of the Itapu Field), there is a need for signing the Co-participation Agreement between the Petrobras Assignee, the Petrobras Contractor and the PPSA as Consenting Intervener (and the approval by the ANP).

In 2019, the first auction was made for the Transfer of Rights Surplus volumes. What was bid and what was the result of the event?

The public session of the first bidding round of the ToR Surplus under PSC took place on November 6, 2019. At the time, the ToR Surplus volumes of the Búzios, Itapu, Atapu and Sépia Areas were offered. The Búzios and Itapu Fields were bidden, generating a revenue of R\$ 69.96 billion in Signature Bonuses only, an amount that exceeds the sum of all Signature Bonuses already paid in Brazil since the second round of Concession bids⁶.

The Contractors for the Production Sharing contracts of Búzios and Itapu are:

Búzios	Itapu
Petrobras (Operator - 90%) CNODC Brazil (5%) and CNOOC Petroleum (5%) Federal Government's Profit Oil: 23.24%	Petrobras (Operator - 100%) Federal Government's Profit Oil: 18.15%

⁵ Brazilian Civil Code, art. 381: “The obligation is extinguished, provided that the qualities of creditor and debtor are confounded in the same person”

⁶ The first round of Concession bids did not generate Signature Bonuses.

Is there already production in the Búzios and Itapu Fields?

The Búzios Field has been in production since April 2018. The Itapu Field is expected to start production in 2023.

The Production Sharing contracts of the ToR Surplus of Búzios and Itapu were signed at the end of March 2020. PPSA acts as the manager in both.

Until the beginning of the effectiveness of the Co-participation Agreements, all production of the Búzios and Itapu Fields will be originally appropriated by the Petrobras Assignee, under ToR regime and the volume produced will be cut down from the total contracted in this regime. From the date the Co-participation Agreements are effective, production (as well as expenses) will be assigned to both contracts, proportionally to the Tract Participations (ToR and PSC) agreed in the Co-participation Agreement.



Credit: Agência Petrobras

The government will offer the Sépia and Atapu Fields in a new bidding round at the end of 2021. What's new?

The novelty for the new round is that procedures were implemented to increase the attractiveness of the areas and the competitiveness of the event.

Even before the public session of the first bidding round of the ToR Surplus under PSC regime, the Federal Court of Accounts (TCU – Brazil) issued the Judgment No. 2,430/2019 – TCU – Plenary session, determining a specific treatment for the blocks that, eventually, would not be acquired in the bidding of ToR Surplus. In fact, TCU prescribed to PPSA and

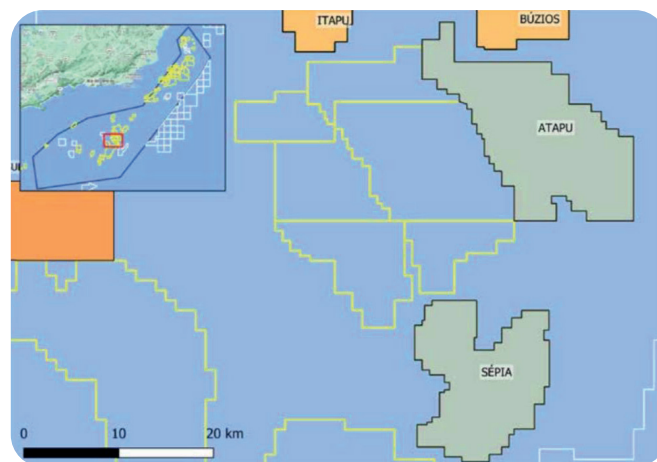
ANP that, if any of the blocks offered were not acquired, the procedures aimed at identifying and delimiting the part of the Federal Government in the respective reservoirs should continue, so that, in their eventual and future contract, the Participation Tract Participations of the ToR Contract and future PSC would already be known.

For this reason, as early as January 2020, the MME published its Ordinance No. 23/2020, qualifying PPSA Petr leo as the representative of the Federal Government to negotiate, with Petrobras, the Tract Participations of the ToR and ToR Surplus in the Co-participated areas. In addition, the regulation empowered PPSA to negotiate, in advance, the amounts of compensation due to Petrobras Assignee for the future contractor under PSC.

MME Ordinance No. 493/2020 amended the MME Ordinance No. 23/2020, adding, to the competencies already attributed to PPSA, the assignment to negotiate, with Petrobras, the parameters for the calculation of the Compensation. For so, art. 2 of Ordinance MME No. 23/2020 established a proposition committee, with members of the MME, PPSA and the Energy Research Office (EPE) with the objective of “defining to PPSA the technical, economic and legal guidelines for the negotiation with Petrobras and calculation of Compensation, considering the current market conditions.”

In addition, the value of the Signature Bonus decreased significantly, as well as the Federal Government’s Minimum Profit Oil, which leads us to believe that the next bidding event will be very attractive.

Finally, note that Petrobras has already exercised, on April 28, 2021, its right of preference in relation to the two offered areas, Atapu and S pia.



Credit: Pr -Sal Petr leo

How has PPSA contributed to the increased attractiveness and competitiveness of the next bid?

In February 2020, following the guidelines of MME Ordinance No. 23/2020, PPSA began the technical evaluation of the Sépia and Atapu reservoirs. Seven months later, the technical reports for Sépia and Atapu Fields were sent to ANP, with emphasis on the reservoir model developed jointly by PPSA and Petrobras.

The Tract Participations for the ToR and the ToR Surplus, agreed between PPSA and Petrobras, based on the aforementioned technical studies, were submitted for approval by ANP, under the terms prescribed by MME Ordinance No. 265/2019. ANP evaluated the technical studies and approved the Tract Participations proposed in December 2020.

At the same time, PPSA and Petrobras calculated the Compensation amount, based on technical, economic and legal parameters negotiated between them and registered in an Agreement⁷ approved by the Minister of Mines and Energy in April 2021. These parameters, as well as the Compensation, were included in MME Ordinance No. 213/2019, with the wording revised by MME Ordinance No. 08/2021.

As a result of this joint work, the pre-tender of the new bidding round for Sépia and Atapu, published by ANP in June 2021, brought, in its provisions, Tract Participations for the ToR and the ToR Surplus (PSC), as well as the Compensation due to the Assignee in each Field, reducing the uncertainties of future Contractors in relation to the expected expenditures.

What are, after all, the Tract Participations of the Sépia and Atapu Fields?

They are:

ATAPU		SÉPIA	
TRACT PARTICIPATION CO	TRACT PARTICIPATION CPP	TRACT PARTICIPATION CO	TRACT PARTICIPATION CPP
39.5%	60.5%	31.3%	68.7%

And what are the Compensation amounts?

The Compensation prior to the taxes on the capital gain of the Petrobras Assignee is US\$ 3,253,580,741.00 (three billion, two hundred and fifty-three million, five hundred and eighty thousand, seven hundred and forty-one dollars) for the Atapu Field and US\$ 3,200,388,219.00 (three billion, two hundred million, three hundred eighty-eight thousand, two hundred and nineteen dollars) for the Sépia Field.

The value of the Compensation can be supplemented annually, between 2022 and 2032, if the Brent Crude price reaches an annual average of more than US\$ 40 per barrel, up to the limit of US\$ 70 per barrel (earn out).

What about the Signature Bonus and the Federal Government’s Minimum Profit Oil?

CNPE Resolution No. 05/2021 approved the technical and economic parameters of the bidding round of the ToR Surplus for the Sépia and Atapu Fields, establishing, among other:

SIGNATURE BONUS	
I – Sépia Field	II – Atapu Field
RS 7,138 billion	R\$ 4,002 billion
FEDERAL GOVERNMENT’S SURPLUS OIL (minimum)	
I – Sépia Field	II – Atapu Field
15.02%	5.89%

Once the amounts of the Tract Participations and Compensation are defined, do interested companies need to negotiate the terms of the Sépia and Atapu Co-participation Agreement?

No. A draft of the Co-participation Agreement was published in the annex to the pre-tender of the bidding round for the ToR Surplus of Sépia and Atapu.

The Sépia and Atapu Co-participation Agreements should be signed, in accordance with the published draft, simultaneously with the signing of the Production Sharing contracts of the ToR Surplus.

However, it does not prevent the Assignee, the Contractors in the Production Sharing regime and the Consenting Intervener from reviewing the signed Co-participation Agreements in the future, submitting an amendment to the approval of ANP.

Will the new Contractors under Production Sharing be immediately entitled to the appropriation of a portion of the surplus production of the Transfer of Rights?

Exactly. The signing of the Co-participation Agreement on the same date of the signing of the PSA gives the new Contractor the right to the original acquisition of a portion of the oil and natural gas, after the recognition, by PPSA, of good standing with the payment of the Compensation.

What about the Federal Government?

Likewise, the Federal Government, represented by PPSA, will originally appropriate its portion of the Profit Oil as soon as the Co-participation Agreement is signed and the recognition, by PPSA, of good standing with the payment of Compensation by the Contractors.

As reported, there is an extensive legal framework on the subject. Where to find this legislation?

The entire legal and normative framework for the surplus production of the Transfer of Rights can be accessed on the PPSA website. Newly updated, the legal framework in the PPSA website is one of the most complete virtual libraries of normative acts on the Brazilian oil and gas sector. Access on (<http://www.presalpetroleo.gov.br/ppsa/legislacao/arcabouco-normativo>).

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