

### Third round in Brazil's pre-salt royalties' fight

In November 2007, the Brazilian Government announced large oil discoveries in the offshore Tupi Complex and caused a massive twist in the oil & gas sector. The guarantee of long-term investments in the market gained strength with the record capitalization of Petrobras, in a total value of almost R\$ 127,1 billion BRL (USD 65 billion), in which the Government participated with R\$ 74,8 billion BRL (USD 42,5 billion).

Meanwhile, there has been an ongoing discussion on the fair distribution of royalties deriving from pre-salt activities, especially at exploration and production. Whilst according to Bill of Law no. 5,938 of 2009, the division of royalties' distribution has the Federal Government obtaining 40% of the royalties, the producing states and producing municipalities a 22.5% amount and, finally, the embarking municipalities and non-producing municipalities and states receive 7.5%, with a sub-division that follows in accordance to the states and municipalities' participation funds in the exploration and production.

Recently, the Senate has been presented with a new matter to decide, which is the "Ibsen amendment", a proposal of modification drafted by representative Mr. Ibsen Pinheiro, by means of a newer law on the distribution of royalties from oil exploration and onerous agreements that derive from pre-salt discoveries, which establishes an equally distributed royalties system, where the Federal Government maintains its 40% share, with the remaining 60% portion being divided by the non-producing and producing municipalities and states. Under the argument in favor that all states end up paying for the research and exploration of Petrobras and the tests in the reserves, which gives reason to eligibility for a common benefit from the royalties, the Ibsen amendment was sent for analysis by the Senate and shall only be picked up for a revision process in 2011. During this time, suggestions came up so as to soften the drastic losses producing states would suffer.

Lately, the government announced that it is wrapping up an alternative proposal for royalties' and special participation (which by the Ibsen amendment would be equally divided between the Federal Government and all States and Municipalities, again

according to the states and municipalities participation funds). According to this proposal, the royalties' percentage of the producing municipalities and states shall be gradually reduced over the next ten years, beginning with a receipt of 90% of the income on the current model basis and the remainder under the new alternate regime basis, with a continuous reduction until, in ten years, the new regime will fully apply.

It is not, however, felt that higher positions in the government, including the national President will avail this as an interesting measure.

Analysts, nevertheless, foresee a substantial loss for producing states; Rio de Janeiro is set to drop its expected revenue collection between the years of 2011 to 2020 from R\$ 168,7 billion to R\$ 75,5. Allegedly, compensation mechanisms might repair only part of these losses, although oil exploration and production is due to experience a high increase over the next years.

The financial compensation for the oil exploration exists so as to compensate the environmental impacts and the costs incurred by the producing municipalities and states to improve their infrastructure. Therefore, the current regime meets a fairly converging point with regards to profits generation due to local production. However, on the verge of having the "Ibsen Amendment" approved in 2011, the alternative proposal internally studied by the government surges, theoretically, as a feedback mechanism.

The perceptible problem due to the approval of "The Ibsen Amendment" is that the producing states are going to pass, sooner or later, through financial problems to support the oil exploration and its consequences. Nowadays, the current royalties' distribution system benefits states and municipalities directly working in oil production whereas by the amendment proposal, the distribution of these resources would be equal with a compensation by the Union of such losses, although on a lower level.

The oil & gas sector comments that these studies performed by Government have a point in formulating a balance in order not to cause excessive losses for the largest producing states, Rio de Janeiro and Espírito Santo, and, moreover, distribute an excessive quantity of resources, especially in municipalities with low per capita income.

In view of this conflict of interest, the representatives of the Brazilian Senate shall analyze attentively the benefits and consequences of the “Ibsen Amendment” and, in case it is approved, Government should adopt mechanisms, as to graduate the losses of the producing states, under the risk of posing a disproportional harm for the oil producing states, which would have no revenues to support its activities. Although a national pride, oil exploration has set to make regional conflicts surge again.