

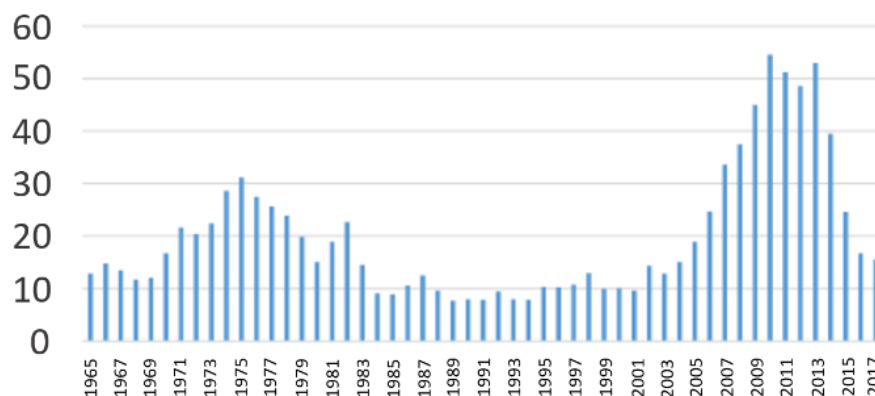
## Financing Trends in the Brazilian Oil and Gas Industry

*This article was contributed by Carlos Frederico Lucchetti Bingemer and Adriana Gondin Da Fonseca Lontra of Barbosa Müssnich Aragão.*

The next few years promise to be interesting times in Brazil. Approval of reforms to modernize the economy are the most important structural measures on the new president's agenda. Reforms relating to the oil and gas industry could not be more favorable.

There is a turnaround in the Brazilian energy sector, compared to recent years, when the industry faced a five-year discontinuance of bidding rounds (2008-2013), the oil price collapse (2014-2016), and a reduction in investments by the Brazilian national oil company, Petrobras, as shown on the following chart:

Petrobras annual investments  
(US\$ billion 2018)

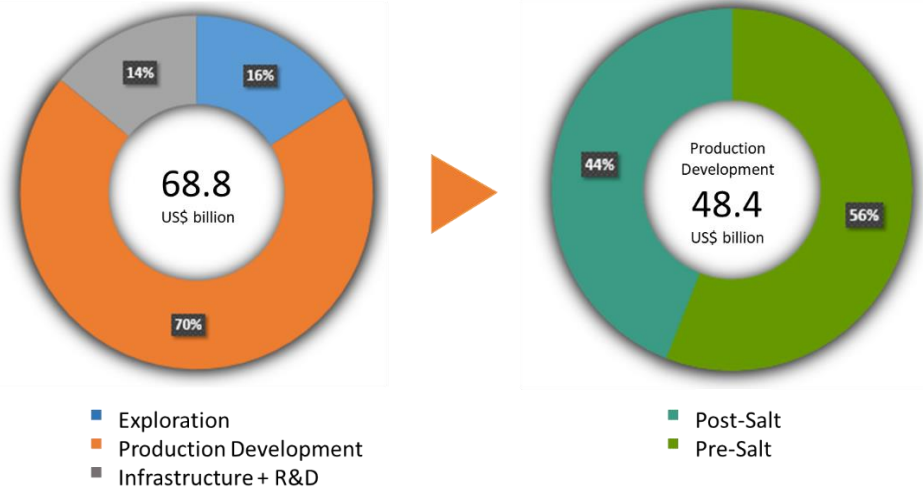


Source: [Petrobras annual investments](#)

Recently, Brazil has seen a comeback in drilling activity and a new era of foreign investment in the sector. Opportunities are particularly attractive in Brazil's pre-salt area, which has proven reserves of approximately seven billion barrels of oil and 195 billion cubic meters of gas (as of December 2017), and is considered to have the largest share of global deep water crude oil production.

The importance of the pre-salt area and deep water reserves in Brazil is reflected in the statement made by Roberto Castello Branco, who was recently appointed Chief Executive Officer of Petrobras by the new government, that for the next several years the company will focus on major deep and ultra-deep water upstream projects.

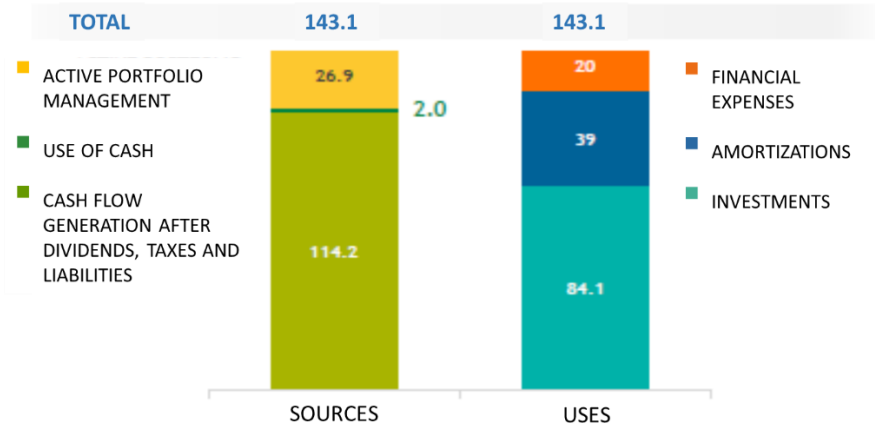
2019 – 2023 E&P INVESTMENTS  
US\$ billion



Source: *Petrobras Strategic Plan 2040 – Business and Management Plan 2019-2023*

This decision by Petrobras, Brazil’s most important oil and gas player, serves to highlight the scale of its divestment plan, which will ultimately turn over to the private sector as many as 100 concessions, including a number of opportunities in onshore and mature fields and shallow water projects. See below for Petrobras’ expectations concerning sources of funds regarding its active portfolio management, which includes partnerships and divestments.

SOURCES AND USES 2019-2023  
US\$ billion



Source: *Petrobras Strategic Plan 2040 – Business and Management Plan 2019-2023*

In addition, since 2013 Brazil's oil and gas regulator, the ANP (*Agência Nacional de Petróleo, Gás Natural e Biocombustíveis*), has carried out nine bidding rounds to grant exploration and production rights to industry operators (four concession rounds and five production sharing rounds). Two bidding rounds are expected in 2019, one for a concession and the other under the production sharing regime. It is also expected the second stage of the open acreage process<sup>1</sup>, will offer 85 exploration blocks from seven onshore basins and 954 areas from 13 offshore basins.



Source: *Agência Nacional do Petróleo – The Oil and Gas Industry in Brazil*

With E&P companies participating in recent and upcoming bidding rounds, there is a need for funds to invest in new projects. Recapitalizing or refinancing projects already in production is one of the strategies available to free up capital and enable investment in new exploration projects.

In short, the Brazilian oil and gas industry is looking forward to a period of growth over the next few years, bringing with it greater investment by the private sector in exploration and production and a greater demand for financing of E&P activities, including secured financing comparable to reserve-based lending. To accommodate such secured financing, there is a need for clear rules in Brazil on how to use E&P contracts and other upstream assets as security.

While in the United States it is common for an E&P company to have ownership of the underlying oil reserves (and thus the right to grant a mortgage on unproduced oil), in Brazil the oil and gas reserves are owned by the Brazilian government, with ownership being transferred to the E&P company only after extraction. As a result, a security interest in upstream assets can only be granted by assigning the concession or the production sharing agreement itself.

<sup>1</sup> The open acreage process is the continuous offer of relinquished marginal oil fields and exploration blocks offered in past bid rounds that were not awarded or which have been returned to ANP.

The ANP is aware that providing clear rules for financing new business is crucial to development of the market and has been working on new rules that are now in the final stage. Among other provisions, the rules include a section dealing with the grant of security interests in rights under Brazilian E&P contracts, including receivables, right to compensation, contingent rights, and even the producer's contractual position.

[View the current draft of the ANP rules.](#)

A public hearing on these draft regulations took place in December 2018, with the participation of sector players and other interested parties. The ANP is considering the public's comments and is expected to issue its new regulation early in 2019.

There are other challenges in the use of reserve-based lending as a funding mechanism in Brazil, among which we can highlight:

- (i) The general possibility of ANP terminating the E&P contract in the case of the operator's insolvency if the contract is not assigned to a third party (the clause may vary depending on the bidding round the E&P contract refers to and has improved in more recent bidding rounds)
- (ii) The need to have ANP's prior approval for any direct or indirect change of the operator leaving uncertainty whether the assignment of the E&P contract will be approved when enforcing the security and timing for such approval

However, the new ANP regulations that will permit private companies that are party to Brazilian E&P contracts to collateralize those contract, are expected to be a key driver in the development of a reserve-based loan funding structure in the Brazilian oil and gas industry.