LOCAL CONTENT

Brazil – Petroleum
Resource-rich countries are increasingly inserting requirements for local content (“local content provisions”) into their legal framework, through legislation, regulations, contracts, and bidding practices. If successful, a policy to increase local content can lead to job creation, boost the domestic private sector, facilitate technology transfer and build a competitive local workforce. However, local content goals are often unfulfilled and the opportunities are not captured. For example, local content provisions typically require investors to meet targets measured as a percentage of investment, hours worked, equipment supplied, or jobs created. If targets are too high, they may either scare away investment or remain unmet as investors accept the fines or find loopholes. If they are too low, the country will not maximize potential linkages. This shows the importance of the framing of local content provisions. Targets, and other local content objectives, need to be carefully quantified, adapted to the local context and collaborative. Because local content provisions can be key to translating resource investments into sustainable benefits for the local population, this project examines the detail of the existing legal frameworks for local content in a number of countries.

CCSI has conducted a survey of the local content frameworks of a number of countries – identifying the key legislation, regulations, contracts and non-binding policies and frameworks dealing with local content issues in the mining and petroleum sectors. A profile was created for each country, summarizing the provisions in the legal instruments dealing with local content and highlighting examples of high impact clauses – those containing precise language which might be useful as an example to those looking to draft policies to enhance a country’s local content. The profiles examine provisions dealing with local employment, training, procurement, technology transfer, local content plans as well as local ownership, depending on the country's approach to and definition of local content. In addition, as key to translating provisions into action, the profiles look at implementation, monitoring and enforcement provisions as well as the government’s role in expanding local involvement. Aside from emphasizing the strong clauses, which may be adaptable across countries, the profiles summarize the provisions but do not provide commentary, because local content is so context specific. The profiles are intended as a tool for policy makers, researchers and citizens seeking to understand and compare how local content is dealt with in other countries, and to provide some examples of language that might be adopted in a framework to achieve local content goals. Hyperlinks are provided to the source legislation, regulations, policies and contracts where available.

1 The project was managed by Perrine Toledano and Sophie Thomashausen. Research was conducted by Kathrin Bausch and Thiago Miotto Palo.

2 General legislation with provisions that relate to local content (for example, tax laws with incentives for local procurement or employment in any industry), was not included in the review. The review included dedicated mining or petroleum sector or specific local content legislation, regulations, policy and contracts.

3 Those clauses are framed and singled out by a "thumb up".

4 Our criteria for assessment of the quality of the provisions were language that is less likely to present a loophole, i.e. less likely to be subject to interpretation due to vagueness and more likely to lead to enforcement because of its clarity in terms of rights and obligations of both parties (state and investor), and reasonable in its obligations on the company. In addition, as mentioned above, we looked for clauses that encourage collaboration between the company and the government in defining local content targets and goals, and those where the government has a role, as well as clauses enabling implementation and monitoring of the requirements and those giving the government strong remedies to enforce companies' compliance.
The Impact of International Law

The World Trade Organization (WTO)'s agreements and investment treaties can present an obstacle to the realization of local content goals by prohibiting some types of local content requirements (a sub-category of “performance requirements”). CCSI therefore surveyed the relevant WTO agreements and investment treaties in each country profiled to identify the provisions that may prevent, counsel against and/or shield local content standards. These provisions are quoted in the profile in order to show the potential barriers to implementation of local content so that they can be kept in mind when countries enter into these international investment treaties. Free Trade Agreements other than the WTO agreements, some of which may contain investment chapters, are not included in the scope of the review, but may also be relevant and should be similarly kept in mind.

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1 Performance requirements are measures in law, regulation or contract that require investors to meet specified goals when entering, operating or expanding in, or leaving a host country. Some are strictly mandatory; others are imposed as a condition for receiving some sort of added benefit or advantage.

2 Countries implementing local content requirements should be aware of the possibility of a challenge to those provisions either through the WTO (state-to-state dispute settlement) or arbitration under the bilateral investment treaties (which is investor-state dispute settlement). While the potential for such actions may be low, they remain a risk depending on the circumstances, and particularly should relations between the state and the investor sour over the course of the investment.
Synopsis

Highlights

- Local content in Brazil is addressed in the context of bidding rounds for Concession and Production-Sharing Contracts. Bidders have to comply with a minimum threshold of local content requirements to win a bid.

- Local content requirements are defined on the basis of percentages. Investors have to ensure a specified percentage of goods and services are sourced locally in the execution of their concession and production-sharing contracts.

- Companies prove compliance with their local content obligations through a local content certificate issued by an independent certifier.

- The penalty for non-compliance with local content requirements is a fine for an amount equal to the monetary value of the non-compliance.
**Key definitions**

- **ANP** means: the National Agency for Petroleum, Natural Gas and Biofuels (Agência Nacional do Petróleo, Gás Natural e Biocombustíveis).
- **Brazilian Company** means: any company incorporated in Brazil, irrespective of the origin of the capital or the nationality of the shareholders, with a few exceptions (Constitutional Amendment No. 6 of 1995, revocation of article 171).
- **Brazilian Supplier** means: any manufacturer or supplier of property produced or services rendered in Brazil through a company incorporated in Brazil, or entity which uses manufactured property in Brazil under a special customs regime and tax incentive applicable to the oil and natural gas industry (Model Contract 2015, Art. 1.3.25).
- **Certifier** means: an entity duly qualified and accredited by ANP to carry out local content certification activity (ANP Resolution 19/2013).
- **Concessionaire** means the company entering into a concession agreement in the form of the Model Contract 2015 with ANP.
- **Local Content** means: the proportion between the value of the goods produced and services rendered in Brazil in accordance with the terms of the Model Contract 2015 and the total value of the goods used and services provided for this purpose. (Model Contract 2015, Art. 1.3.15).
- **Local Content Certification** means: the set of activities carried out by an entity duly accredited by the ANP, with the objective to attest publicly, by means of the issuance of a local content certificate to determine, among others, the goods and services meeting the local content requirements as set out in the ANP-issued Local Content Booklet contained in Annex II of ANP Resolution 19/2013 (ANP Resolution 19/2013).
- **Local Content Certificate** means: the document issued by a Certifier in the form of Annex I to ANP Resolution 19/2013 which states the percentage of local content of, among other things, the goods and services used (ANP Resolution 19/2013).
Rights application

- Compliance with a minimum threshold of local content requirements is a criterion for winning a bid.

Employment and Training

- There are no employment or training requirements in the Brazilian legal framework for local content.

Procuring of goods and services

- Concessionaires have to meet local content targets when procuring goods and services. Local content certificates establish whether those local content targets have been met.

Technology Transfer

- Concessionaires are required to spend 1% of gross revenues on research and development.

Monitoring and Enforcement

- A Concessionaire has to prove compliance with its Local Content obligations to ANP by presenting a Local Content Certificate.
- Local Content Certificates are issued by independent, ANP-accredited Certifiers.
- Non-compliance triggers a fine that is calculated on the basis of the monetary value of non-compliance.

Implementation

- The National Energy Policy Council (CNPE) develops Brazil’s Local Content policy and the ANP oversees its implementation.
- The Tender Protocol and the Model Contract 2015 set out the specific Local Content obligations.
• The Tender Protocol 2015 (Bid Round No. 13) stipulates that the bid offers should include local content commitments (Tender Protocol 2015, Arts. 6.3.3 and 6.5).

LOCAL CONTENT COMMITMENT

“6.3.3 It shall be considered for scoring purposes, only the percentage of local content that are included between the minimum and maximum values defined in Table 7. (…) The overall percentage of local content in the exploration phase and in the production stage of development, calculation object on offer, it shall be automatically generated by the computer program supplied by ANP, as provided in section 6.4, and it shall be calculated from the content percentage place offered for each of the items and sub-items listed in the tables of Annex XIV, weighted by the weight of said item and sub-item in planned investment for its activity (exploration or development of production). The weight of each item should be proposed based on the total cost of the project.”

BIDDING OFFERS CRITERIA

“6.5 The evaluation of the bids it shall be done individually for each block, by attributing points and weights, as indicated below.
(…) c) local content it shall have 20% in the calculation of the final grade of the bidder or bidder consortium, as detailed in section 6.3.3. Of this, 5% it shall be allocated to local content offered for the exploration phase and 15% it shall be allocated to local content offered for production development stage.”

• In previous biding rounds for blocks in the Border Strip area, the tender documents stipulated that at least 51% of its capital must belong to Brazilian nationals (Tender Protocol 2015, Art 6.3).
• There are currently no employment or training requirements in the Brazilian legal framework for local content.

• However, there were some local employment requirements in previous bid rounds for blocks in the Border Strip area. The requirements were as follows:
  • at least two thirds (2/3) of employees were required to be Brazilian nationals; and
  • the administration or management of the concession had to be assigned to a majority of Brazilian nationals (Tender Protocol 2014, Art. 6.3).
The Concessionaire must give preference to Brazilian suppliers, whenever their goods are competitive with non-Brazilian suppliers in terms of price, time delivery and quality (Model Contract 2015, Art. 20.1.2). Brazilian suppliers need to be invited to submit proposals and the bid tenders should be in Portuguese. Affiliates of Concessionaires are subject to the same Local Content requirements with the exception of some services. (Model Contract 2015, Art. 20.2).

The Concessionaire must meet the Local Content commitments set out in Annex IX of the Model Contract 2015, which specifies the commitment to procure local goods and services made in the winning bid of the relevant block (Model Contract 2015, Art. 20.1.1).

The Model Contract 2015 specifies how to measure the achievement of the commitments Model Contract 2015, Arts. 20-4, 20.6):

“20.4 For the purposes of benchmarking, the Local Content of Property and services shall be expressed in percentages in relation to the amount of the good or service purchased or hired.

20.4.1 The Local Content of Property and services shall be proven to ANP through the presentation of certificates of their Local Content, or from document which shall replace the former one, as per applicable legislation.

20.4.2 The Property and services whose Local Content is inferior to 10% (ten percent) shall be considered as aliens in the computation of Local Content for the fulfillment of the contractual obligations.

20.4.3 Notwithstanding the above provision, the Local Content on the purchase of drills, as well as the maritime projects of seismic data acquisition and chartering of drilling rigs, shall still be considered even if its Local Content is inferior to 10% (ten percent).

20.5 For the determination of the percentage of Local Content, the monetary values corresponding to the purchases of Property and services shall be updated for the month and year in which the verification of compliance with the provisions in this clause is accomplished, using the General Market Price Index (IGP-M) of Getulio Vargas Foundation, or other of which shall replace, upon ANP criteria.

20.6 The milestones for Local Content measurement by ANP shall be:

a) The end of the Exploration Phase;

b) The end of each Module of the Development Phase; or

c) The closure of the stage of development in a field which shall not include modular development.”
The Model Contract 2015 also specifies exceptions to the targets (Model Contract 2015, Art. 20.8-20.10):

“20.8 ANP may exempt the Concessionaire from the compliance with the Local Content percentage of which it is committed in relation to recruitment of a specific good or service up to the limit of the minimum required percentage in the bidding for the respective item or sub-item of commitment, especially when:

a) There is no Brazilian supplier for the purchased product or contracted service;
b) All proposals received from Brazilian suppliers present an excessive delivery limit in relation to non-Brazilian counterparts;
c) All proposals received from Brazilian suppliers present an excessive price in relation to non-Brazilian counterparts; or
d) There is no replacement of a certain technology for which there is no offer with Local Content. In this case the exemption of compliance with Local Content only applies to Property and services replaced by new technology.

20.8.1 The exemption from the requirement of compliance with the Local Content shall not extend to the overall percentage of Local Content.

20.8.2 The request must be made in a reasoned way and presented to ANP during the duration of the phase or step in which the exemption is intended.

20.8.3 Concessionaire is obliged to prove the accomplishment of the alleged conditions for the granting of the exemption.

20.9 The request for exemption must be made in detailed form and presented towards ANP throughout the duration of any phase or stage in which the exemption is intended, pursuant the minimal presentation of certain acknowledgements by Concessionaire, cumulatively:

a) To ensure broad and equitable conditions of competition for non-Brazilian counterparts when carrying out calls for proposals for the proper supply and / or attempts to hire from Brazilian Suppliers;
b) To adopt the Local Content as selection criteria, when performing bidding for supply, once the corresponding contract took place with non-Brazilian suppliers, as a result of not complying with the requirements of price, delivery time and quality; and
c) To maintain updated information together with associations or similar business associations union or bodies of knowledge of the subject, in regard to the existence of Brazilian Suppliers to be able to submit proposals for supply.

20.10 The exemption from compliance upon Local Content:

a) Shall be granted to one or more contracts related to the same item or sub-item of Annex IX;
b) Shall prevent the possible assignment of any surplus in the domestic currency, the Local Content of the item to which the contract relates to another addressed item;
The Model Contract 2015 also specifies the circumstances in which the Local Content targets can be adjusted, or where a surplus over and above a Local Content commitment can be transferred to another good or service or carried forward (Model Contract 2015, Art. 20.11-20.15):

“20.11 If the Concessionaire exceeds the Local Content of which it undertook, in particular item or subsection of commitment, the surplus value in local currency may be transferred to other item or subsection of commitment, as long as it refers to the same Phase or Stage.

20.11.1 Assignment of Local Content surplus should be appointed to item or sub-item as specified reference.

20.12 If the Concessionaire exceeds the Local Content of which undertook, whether in the Exploration Phase, whether in a Development Stage Module, the surplus value in local currency may be transferred to the Module the Development Stage is deployed subsequently.

20.12.1 The assignment of the Local Content surplus shall be directed to the modules of the development phase in the order of their deployment.

20.12.2 Any balance in excess of Local Content may be transferred to Modules of the subsequent development phase.

20.13 If the concessionaire exceeds the Local Content which undertook, either at the exploration phase or in a module of the development phase, the surplus amount, in Real, may be transferred to the module of the development phase to be implanted thereafter.

20.14 The Concessionaire may request ANP a Local Content percentage revision particular item of Table of Annex IX to which it is committed.

20.15 The request must be made in a reasoned way and presented to ANP during the duration of the phase or step in which the exemption is intended.”
The Model Contract 2015 requires Concessionaires to fund research, development and innovation at the level of 1% of gross revenues (Model Contract 2015, Art. 20.4):

“24.1 If the special share is due to a field in any quarter of the calendar year, the Concessionaire shall be obliged to carry qualified expenses with Research, Development and Innovation in the areas of interest and topics relevant to the sector of Petroleum, Natural Gas and Biofuel, in an amount equivalent to 1% (one percent) of the Gross Revenue of the production for such field.

24.1.1 The amount referred to in this paragraph is due for each field, originated from the Concession Area.
24.1.2 The Concessionaire shall have up to the 30th June of the year following the calculating calendar year of the gross revenue of production to employ the application of these resources.
24.1.2.1 The Concessionaire shall provide ANP with a full report of the qualified expenditures with Research, Development and Innovation, in the deadlines and formats defined in the applicable legislation.

24.2 At least 50% (fifty percent) of the resources provided in paragraph 24.1 shall be intended for universities or research and development institutes accredited by ANP for the implementation of activities and projects approved by ANP in relevant subjects or priority area, defined in accordance with paragraph 24.6.

24.3 At least ten percent (10%) of the resources mentioned in paragraph 24.1 must be intended for the hiring of activities of research, development and innovation in companies supplying the oil industry, in order to increase the ability of the industries for the purposes of Local Content.

24.4 The rest of the resources provided in subparagraph 24.1 could be for the activities of research and development and innovation, in lines of research or projects determined by the Concessionaire. The resources mentioned in this paragraph may be spent on facilities of the own Concessionaire or through its affiliates, provided it is located in Brazil, or contracted by the companies based in Brazil and associated with ANP, irrespective of the fact of these involve or be related to the operations of this Contract.

24.5 Eventual qualified expenses with Research, Development and Innovation carried out by the Concessionaire at amounts greater than the equivalent to 1% (one percent) of the Gross Amount of production or whenever obligations is not deemed to perform such Expenditures, as per paragraph 24.q, may be compensated on behalf of the Concessionaire for the proof of this requirement in future phases of this Contract.

24.5.1 Such compensation is restricted to the applicable legislation.

24.6 A Technical-Scientific Committee, with responsibilities and composition as defined in a Resolution of ANP, shall annually prepare and publish a list of priority areas, activities and projects of interest and relevant topics in research, development and innovation for the Oil, Natural Gas and Biofuel industry.

24.7 In case of the Concessionaire is not intended to address all resources as highlighted by paragraph 24.1 the performance of Expenses Classified as Research, Development and Innovation through June 30 of a given year, the missing amount should be invested in the following year, plus 20% (twenty percent)."
• **Law 9478/1997** creates the National Energy Policy Council (CNPE, Conselho Nacional de Política Energética), a body responsible for developing Brazil’s national energy policy. As modified by Law 12.351 of 2010, this policy – among other objectives – aims to increase Local Content in the oil and gas sector by establishing a minimum threshold of local content in bids, concessions, and production-sharing contracts (Law 9478/1997, Art. 2).

> “Article 2. It is herewith established the National Energy Policy Council – CNPE, linked to the Presidency of the Republic and presided by the Minister of Mines and Energy, whose duty is to propose national policies and specific actions to the President of the Republic, aimed at:

> […]

> X – promoting the increase of minimum local content rates for goods and services, to be observed in bids and concessions and production sharing contracts, pursuant to item IX (added by Law 12.351/2010).”

• **Law 12.351/2010** outlines the bidding process for production-sharing contracts which includes bidding on local content (Arts. 10 and 15). It also modifies part of Law 9478/1997 when it comes to the local content requirements in bidding referred to above.

> “Article 10. The Ministry of Mines and Energy shall have the following competencies, among others:

> […]

> III – to propose to the CNPE the following technical and economic parameters of the production-sharing contracts:

> […]

> e) minimum local content and other criteria related to the development of the national industry”

> “Article 15. Tender protocol shall be accompanied by the respective basic draft contract and shall indicate:

> […]

> VIII – minimum local content and other criteria related to the development of the national industry”
In 2007, the ANP regulated the certification of Local Content and associated reporting requirements in ANP Resolutions 36, 37, 38 and 39.

ANP Resolution 19/2013, replacing ANP Resolution 36/2007, redefined the criteria and procedures for implementing the Local Content Certification system administered by the ANP. This system provides for the monitoring of the Local Content obligations of Concessionaires (ANP Resolution 19/2013, Preamble, Arts. 24 and 43).

**Preamble:**
"Considering the clause of the aforesaid contracts provides the commitments of the dealers, assignee and hired parties as for the local purchase of goods and services will be evidenced before ANP by submitting local content certificates;

Considering the clause of the aforesaid contracts provides the dealers, assignee and hired parties should request from their goods and services suppliers the appropriate certifications of their products and that the suppliers may, through their own initiative, get the certification of their products in advance;

Considering the clause of the aforesaid contracts establishes the certification activities are carried out by entities duly qualified and accredited by ANP, based on criteria defined beforehand by the Agency itself;

Considering the clause of the aforesaid contracts provide it is incumbent upon ANP to propose the technical regulations concerning the certification of local content, as well as control and monitor the compliance with the commitments of local content of contracts for the exploration and development activities of the production of petroleum and natural gas;

Considering the need to follow the Government’s Local Content Policy defined by means of the guidelines issued by the National Council of Energy Policy, under the coordination of the Ministry of Mines and Energy, discloses the following act: “

(...)
“Art. 24. The certifier, during the work of certification, should have access to all the information necessary to perform and complete of the certification work contracted.”

(...)
“Art. 43. The certifying agency, after the completion of the work of calculating, must issue a Local Content Certificate according to the model in Annex I of this Resolution, indicating the percentage of local content of the product or service.”


ANP Resolution 38/2007 establishes the criteria and procedures for auditing Certifiers. The following documentation is part of this Resolution: Annex I – Notification of Beginning of Audit, Annex II – Auditor’s Opinion, Annex III – Warning Notice.
Monitoring and Enforcement

- The Model Contract 2015 includes auditing requirements (Model Contract 2015, Arts. 27.1 27.5):

  “27.1 The Concessionaire must, in accordance with the applicable law:
  
  (…) 
  a) … keep all documents, books, papers, records, and other parts, in order to corroborate with documents as requested for the measurement of Local Content and Governmental and Third Parties Share which may support the accounting records;(…) 
  d) … submit to ANP quarterly expenses on exploration, development and production and the local investments report in exploration and development, in accordance with applicable law.

  (…) 
  27.2.5 The Concessionaire must keep at the disposal of ANP certificates of Local Content, in addition to contracts, tax documents and other proving records corresponding to the good or service purchased, for a term of 10 (ten) calendar years.”

- The Model Contract 2015 stipulates that fines will be issued for non-compliance with Local Content commitments. The amount of the fine is calculated in accordance with a formula based on the monetary value of the Local Content commitment (Model Contract 2015, Arts. 20.11-20.14).
International Law – WTO Agreements

Agreement on Trade-Related Investment Measures (TRIMs)\(^1\)

- Brazil has been a member of the WTO since January 1, 1995.

- All World Trade Organization (WTO) Members must adopt and abide by the obligations of TRIMs. This can impact a country’s ability to impose certain local content requirements (referred to as “investment measures”), to the extent they affect trade in goods.

- The following types of local content requirements are covered by TRIMS\(^2\):  
  - requiring a company to purchase or use products of domestic origin – TRIMs prohibits discrimination between goods of domestic and imported origin;  
  - limiting the amount of imported products that an enterprise may purchase or use depending on the volume or value of local products that the enterprise exports;  
  - restricting foreign exchange necessary to import (e.g., restricting the importation by an enterprise of products used in local production by restricting its access to foreign exchange); and  
  - restricting exports.

\(^1\) The TRIMs Agreement clarifies existing rules contained in Articles III (National Treatment Obligation (NTO)) and XI (Prohibition on Quantitative Restrictions) of the General Agreement on Tariffs and Trade (GATT), 1994.

\(^2\) It is important to be aware of the types of measures prohibited under the TRIMs Agreement, in order to avoid the potential for dispute settlement under the WTO - a state can bring an action against another state for an alleged violation of the TRIMs Agreement (i.e. “state-to-state action”).
General Agreement on Trade in Services (GATS)

- A separate WTO agreement, the General Agreement on Trade in Services ("GATS"), covers investment measures related to services (in Article XVI), including the following which are relevant to local content:
  - Requirements to use domestic service suppliers
  - Limits on the number of service suppliers
  - Limits on the total value of service transactions or assets
  - Limits on the total number of service operations or quantity of service output
  - Limits on the total number of natural persons permitted
  - Restrictions on or requirements for certain types of legal entities (e.g., joint venture requirements)
  - Imposition of domestic equity

- GATS only applies to those service sectors that the country chooses to include in its Schedule of Commitments. Brazil’s Commitments relating to engineering services and construction may affect the implementation of the local content commitments stipulated by the tender Protocol and the Model Contract 2015.
As of May 23, 2015, Brazil has entered into 14 Bilateral Investment Treaties (BITs) of which none are in force.¹

BITs are international agreements between two or more countries which establish the terms and conditions of foreign investment within each country and provide rights directly to the investors of each country which is party to the treaty. The treaties can contain restrictions on local content requirements.²

Investment treaties can contain the following types of provisions, each of which affects a country’s ability to impose local content requirements:

- non-discrimination provisions (“national treatment” and “most-favored nation” obligations), which are relevant in the context of local content when:
  1. host countries require some foreign investors to source from certain goods and service providers but don't impose similar requirements on other investors; and
  2. host countries give an advantage to some domestic or foreign goods and services providers, but not to a foreign provider whose state has a relevant treaty with the host country. (Note that this is relevant only where the foreign provider of goods or services has or, intends to have³, a presence in the host country);

- restrictions on capital transfers;

- “pre-establishment” protections, which prevent a state from imposing conditions on foreign investors that are not imposed on domestic investors, such as requirements to transfer technology to local firms, to establish the firm through a joint venture, or to reinvest a certain amount of capital in the host country;

- incorporation of the TRIMs agreement; and

- explicit prohibition of performance requirements that go beyond what is restricted by the TRIMs Agreement.

¹ According to UNCTAD’s country specific list of bilateral investment treaties.

² It is important to be aware of the BITs a country has signed and the types of requirements prohibited under it, in order to avoid the potential for arbitration against the country - the majority of investment treaties allow investors to bring arbitration claims directly against the country in which they have invested (“investor-state arbitration).

³ I.e., the conditions under which an investor may enter into the territory of a party, not only the conditions once the investment is made.
• Of the 14 BITS signed by Brazil, nine are available and were reviewed (and are available on UNCTAD’s database).

• Aside from the inclusion of National Treatment Obligations and Most Favored Nation clauses, which are included in most BITs, performance requirements are generally not specifically prohibited in the BITs reviewed.