



Local Content Policy in Brazil: Lessons Learned

Windhoek, April 2019



1

Definition

The proportion between the value of the goods produced and services rendered in the country for the execution of the contract and the total value of the Property used and services provided for this purpose

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Local Content Policy – Objectives

- Improvements in professional training
- Technological development
- Enhanced competitiveness amongst domestic companies
- Increased participation in the provision of goods and services by domestic companies

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Why does the country invest in a Local Content Policy?

To increase the contribution of domestic manufacturers in the sector, hence bringing competitiveness to the industry and fostering job creation and income to Brazilians

How is the Local Content Policy applied

- Local Content is a contractual clause inserted in E&P contracts signed between the concessionaire and the government

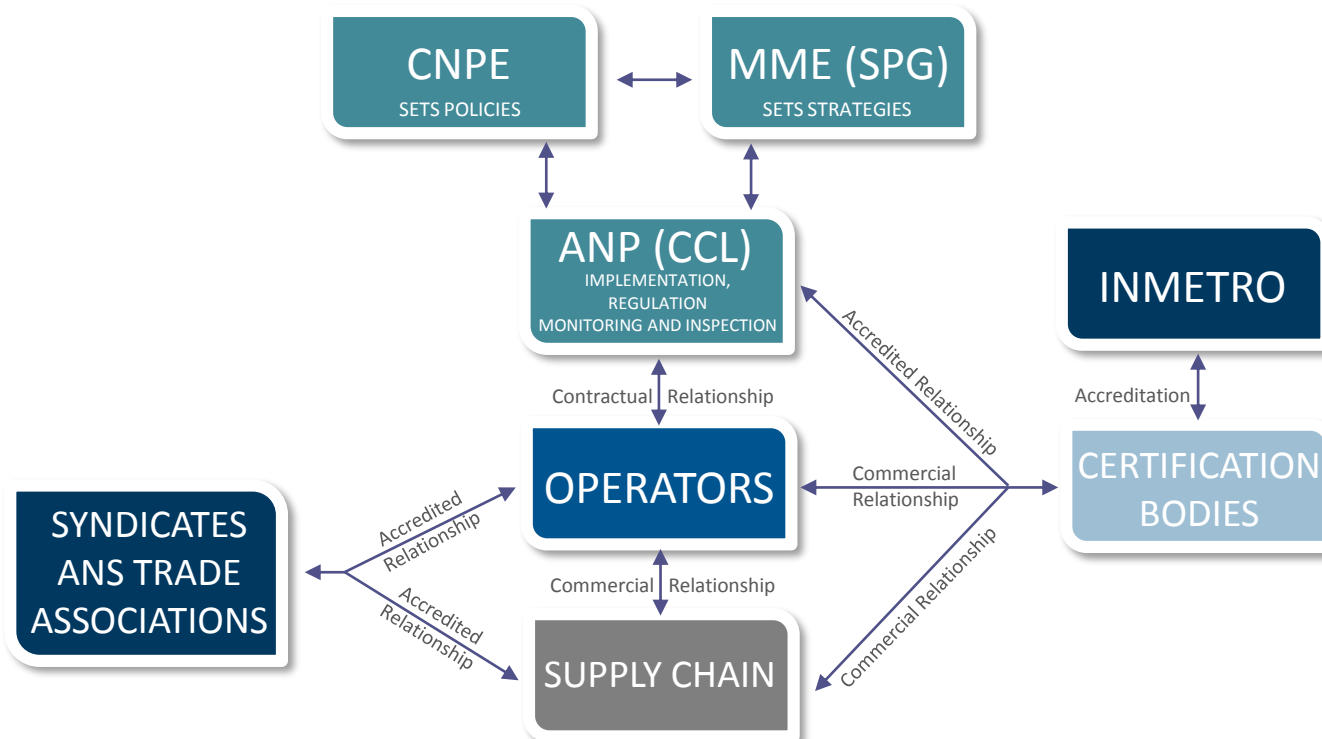
The clause states that

- the buyers' internal tenders for the acquisition of goods and services must include Brazilian suppliers among the companies invited to submit proposals;
- the concessionaire should assure preference to Brazilian suppliers whenever their offers display;
 - price, delivery and quality equivalent to those from foreign counterparts.



Local Content Governance

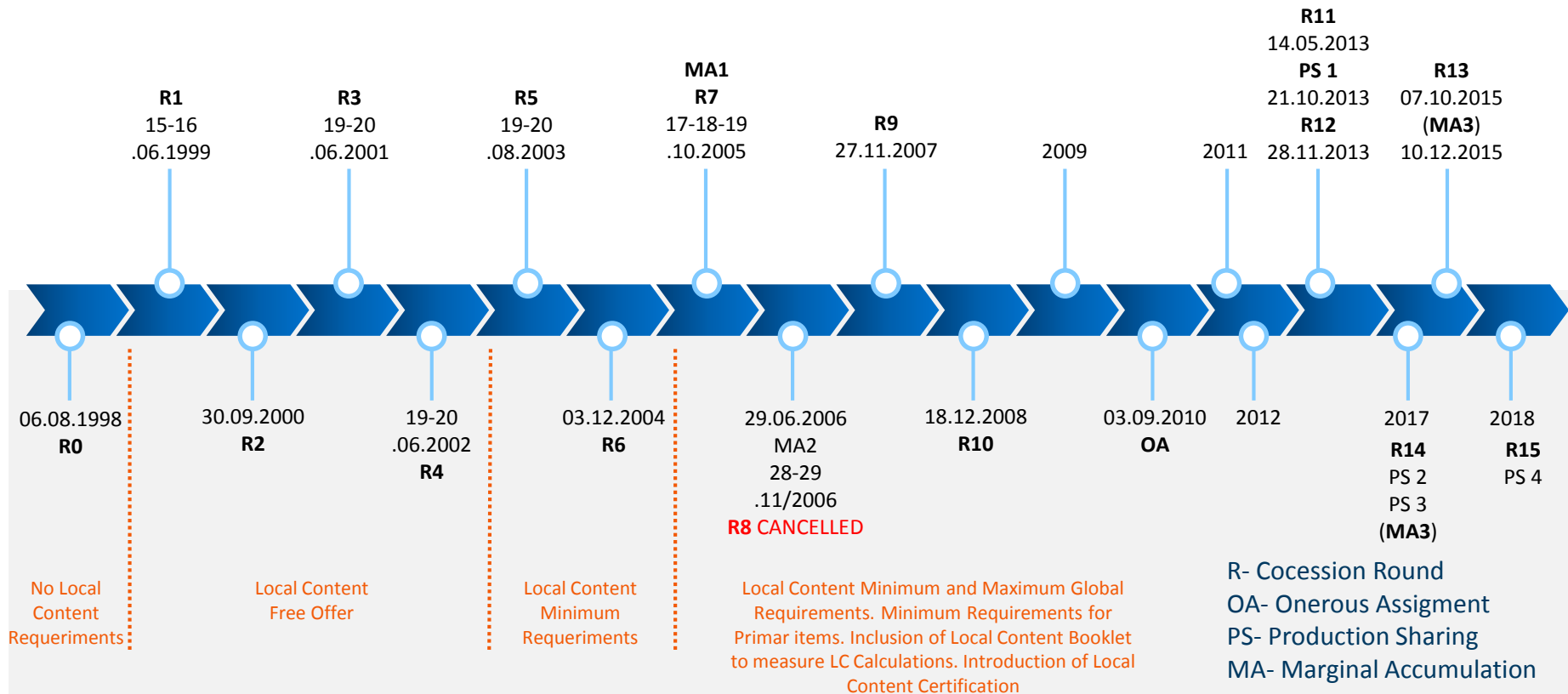
CNPE determines the Brazilian Content policies;
Ministry of Mines and Energy sets the national strategies ;
ANP implements the policies, regulates, and monitors the market



Program Outline / LC Evolution / Bidding Rounds

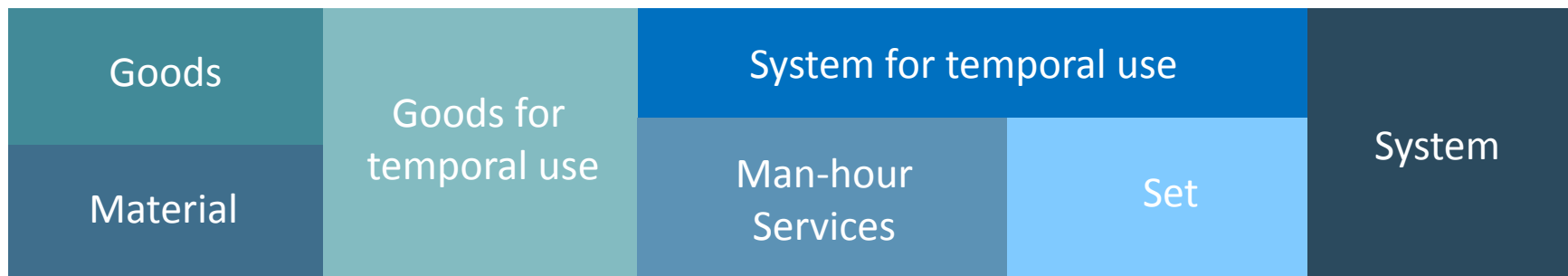
Bidding Rounds Timeline

Since 1998 there have been 15 Concession Bidding Rounds, 4 Production Sharing Round (Pre-salt fields), 3 Marginal Accumulations Rounds and 1 Onerous Transfer of Rights round.



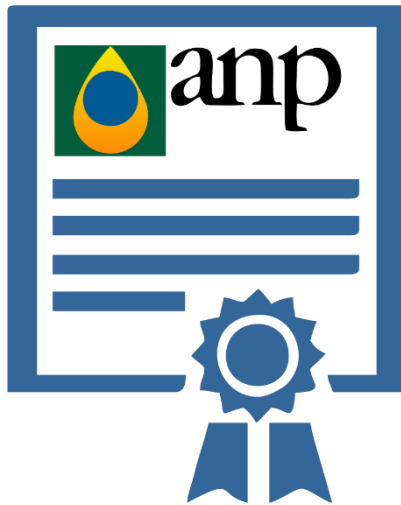
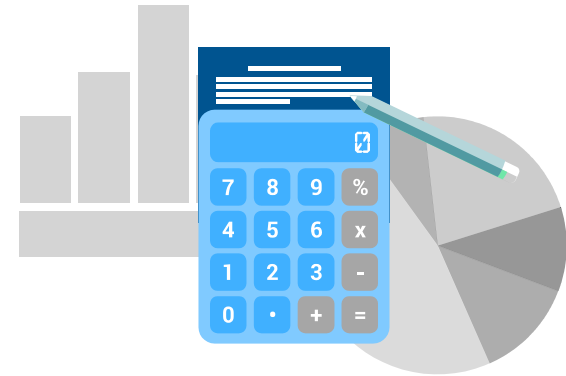
Local Content Methodology

- Local Content commitments agreed at the contracts should be demonstrated to ANP by the emission of a Local Content Certificate;
- The Certificates can only be issued by a Certification Body officially accredited by ANP. Thus, companies must seek the services from the Certification Bodies to obtain Local Content Certificates for their goods and services;
- The methodology applies to all existing regimes for the E&P of oil and natural gas in the upstream sector in Brazil: Concession, Production Sharing and Onerous Transfer of Rights;
- The methodology follows the ANP guidelines set forth via resolutions, which defines the use of the Local Content Primer to calculate Local Content percentages;
- The goods and services subject to certification can be classified under **7 types**:



Local Content Methodology

- The Local Content Primer also sets a series of formulas to be used to calculate each type of certification
- While the formulas vary according to the type of certification, the main purpose remains to isolate the foreign components from a given good or service and measure its weight according to the overall price of the good or service



Local Content Certification

- There are over 20 Certification Bodies currently accredited by ANP to perform certification activities
- The Certification Bodies issue Local Content Certificates to their clients (concessionaires or service companies in the supply chain)

Local Content Monitoring and Inspection - ANP



CONSTANT MONITORING

ANP constantly monitors via reports sent by both players to the Agency;

3

STAGES

ANP monitors Local Content figures at the following stages:

- at the end of the Exploration Phase;
- at the end of the Development of Production Stage;
- when the exploratory block is relinquished and the Concession Contract is terminated;



REQUIREMENTS

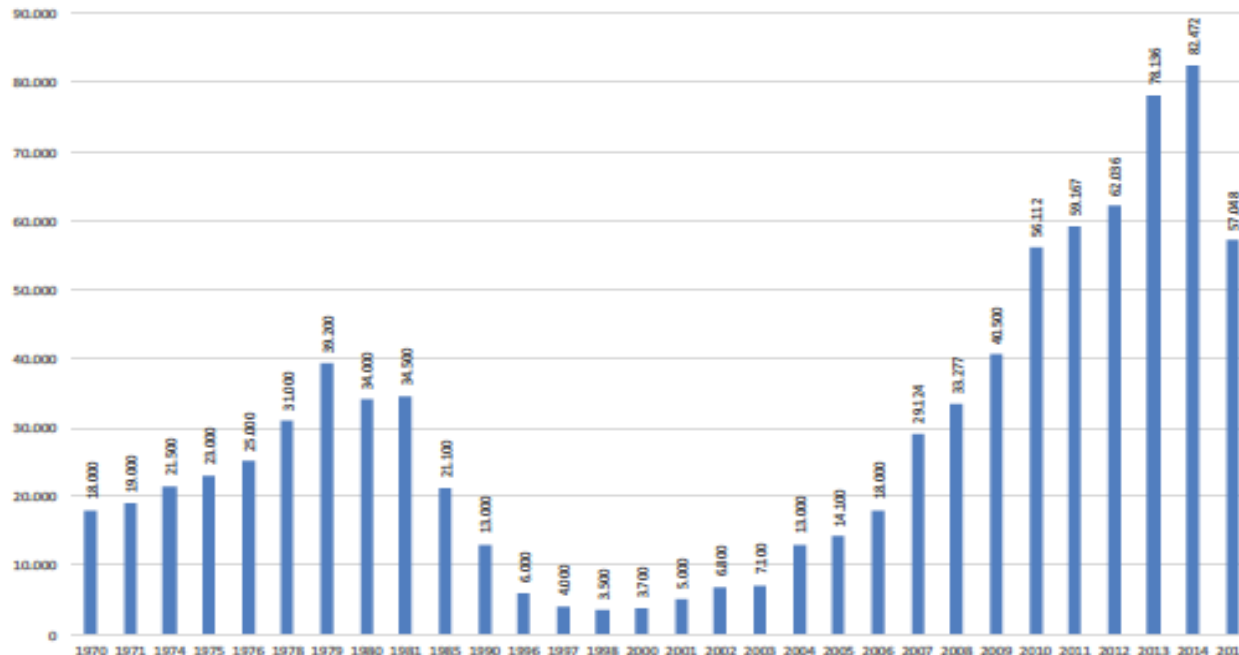
If the Local Content percentage calculated by ANP is equal to or greater than the values listed in the E&P Contract, ANP considers that the requirements have been fulfilled.

Local Content Effect on Supporting Industries

- Resurgence of the shipyard industry.
 - The number of employees jumped from less than 3,000 in 2003 to over 80,000 2013.
- The subsea segment deserves a special mention, as all relevant global OEMs established new manufacturing plants in the country.
 - This allowed for the production of subsea equipment at high Local Content levels.
 - The OEMs also invested in national R&D, setting up their R&D Centers in Brazil.



Direct Jobs at Brazilian Shipyards

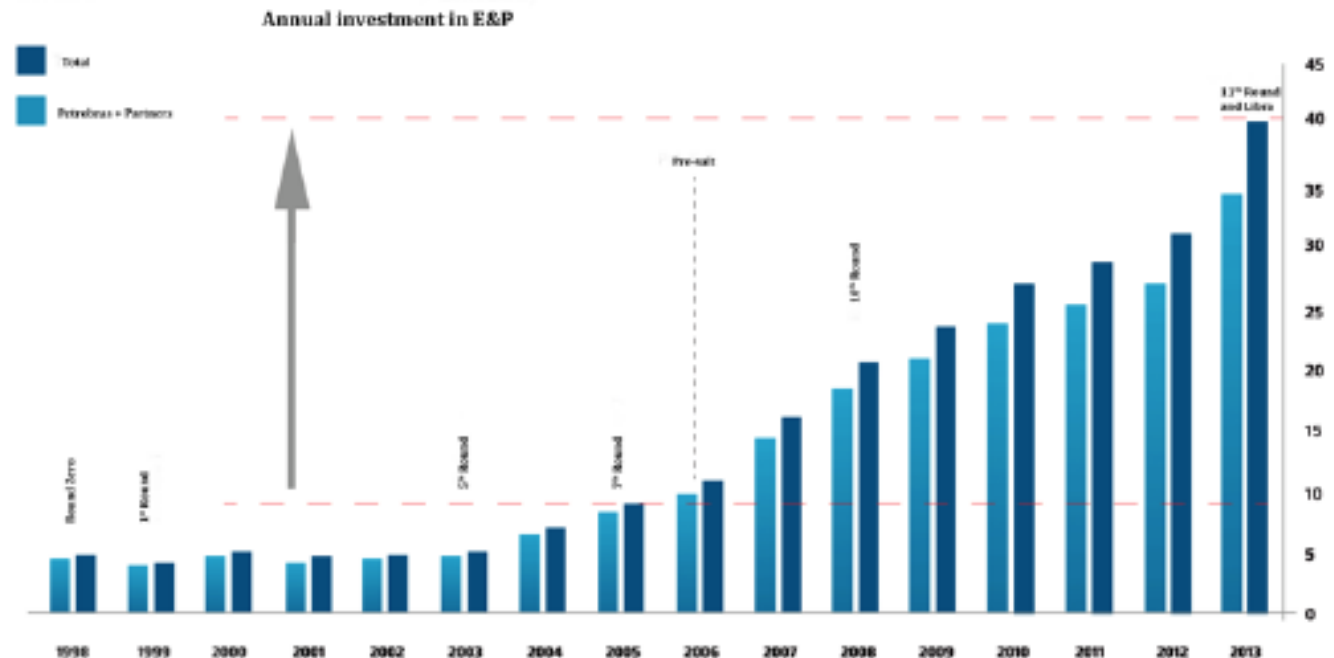


Source: SINAVAL (2013) and IPEA (2014)

Local Content Effect on Supporting Industries

Growth in investment in the E&P sector:

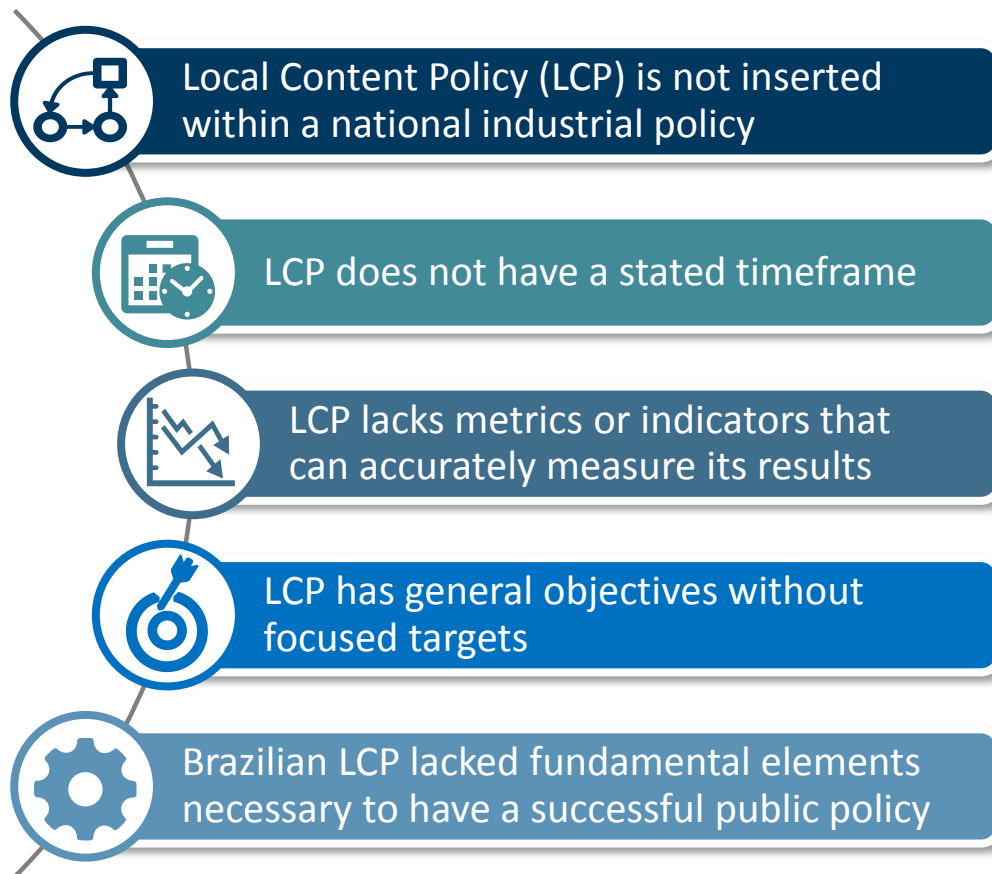
- 2000 - received investments in the order of US\$ 4 billion.
- 2013 - risen to US\$ 40 billion.
- This sizeable growth brought both positive and negative effects to the industry, because arguably not a single industry in the world would be to cope with this substantial growth in such a short period of time.



ANP

The Federal Court of Accounts (TCU) audited ANP and noted that the Agency had difficulties implementing activities associated with the Local Content methodology:

ANP agreed with the TCU's conclusions that Local Content should be included in a broader industrial framework at multi-ministerial level, with clear objectives set and reasonable targets, always bearing in mind the competences and vocations of the national industry.

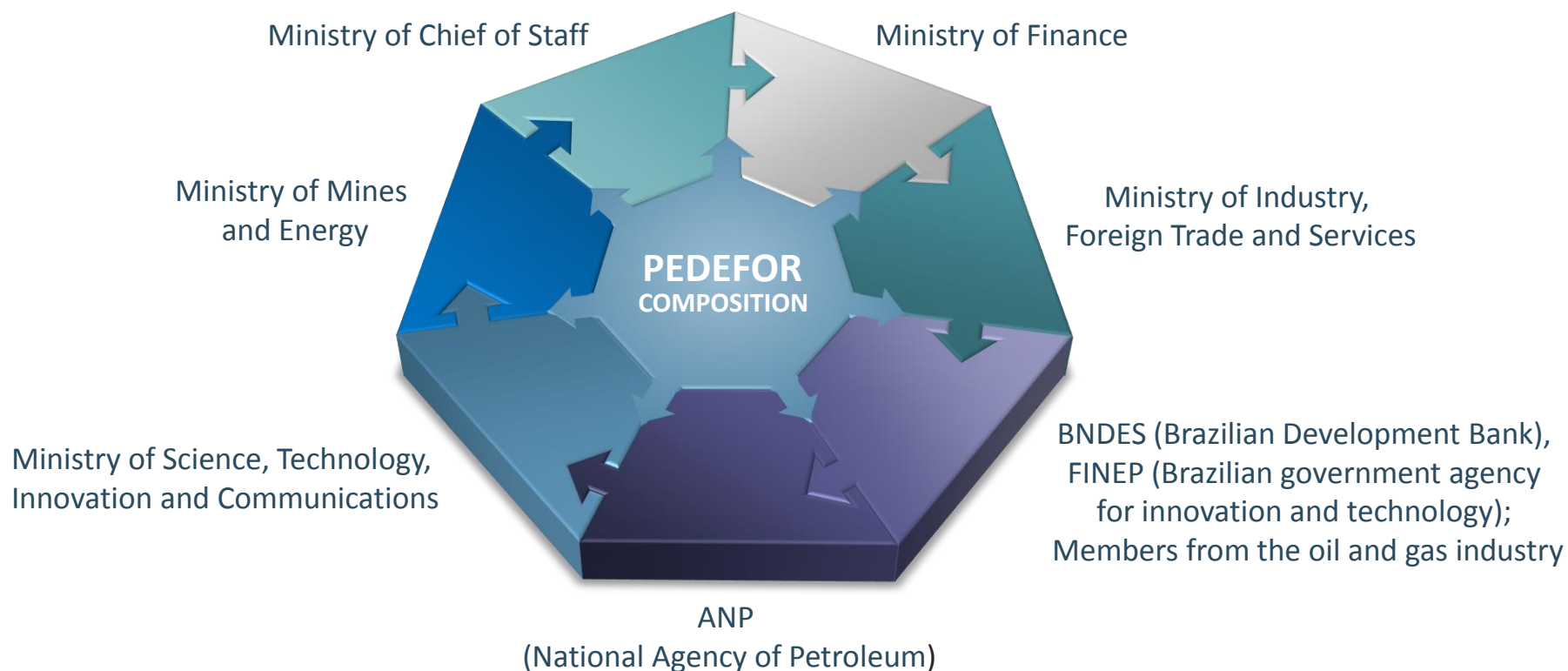


Local Content – Industry Perception (PEDEFOR)

The Program to Encourage Supply Chain Competitiveness and the Development and Improvement of Suppliers in the Oil and Natural Gas Sector is designed to stimulate the domestic supply chain and provide incentives for operators and service companies that invest large sums of money towards developing the sector in Brazil

PEDEFOR's Composition

Representatives from the Executive Office's from the following Institutions:



PEDEFOR's Main Objectives



Increase the domestic supply chain's competitiveness



Encourage domestic engineering



Promote Technological innovation in strategic sectors



Expand the chain of companies supplying goods, services and systems in the country



Increase Local Content levels



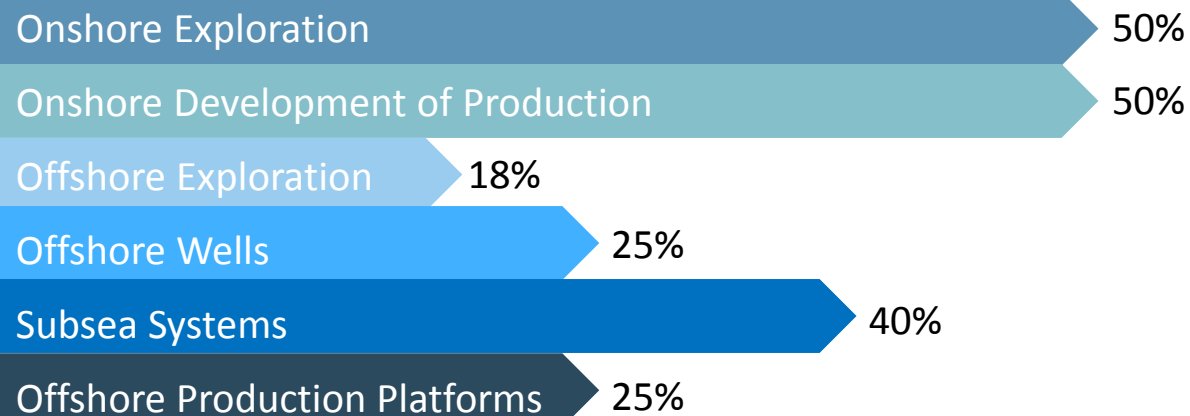
Encourage the development of technology-based companies

The CNPE New Local Content Resolutions

On March 27th 2018, the Official Gazette of the Union published 2 PEDEFOR Resolutions (Res. nº. 1/2018 and Res. nº 2/2018) that will have large impacts in the Local Content Policy in Brazil:

- The resolutions allow ANP to retroactively **revise** Local Content requirements (LCR) for contracts signed between the 7th and 13th Concession Rounds, 1st and 2nd Production Sharing Rounds and the Onerous Assignment contracts.
- The revised LCRs of past contracts should be pursuant to the percentages approved for the Bidding Rounds held as of 2018.
- ANP will allow the oil companies to choose the LCRs on any of their E&P contracts, granted the choice remains restricted to either the requirements set in the existing contracts, or the percentages approved by CNPE Resolution nº 7/2017.
- The exemption mechanism (waiver) is no longer applicable to E&P Contracts.
- The revised Local Content percentages are as follows:

SEGMENT | MINIMUM LOCAL CONTENT (%)



Act ANP n° 726/2018 – Contractual Amendment

Amendment

Applicable to all existing contracts

Proposal: The new clause reflects more recente contracts, with the exception of the minimum commitments of the UEP

(stationary Production Unit) group, which is divided into three segments*

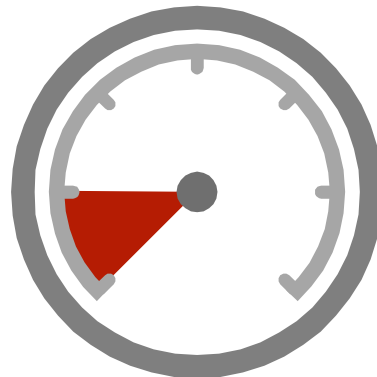


| | | |
|----------------|------------------------|-----|
| Onshore | Exploration | 50% |
| | Production Development | 50% |

| | | | |
|-----------------|------------------------|----------------------------|-----|
| Offshore | Exploration | | 18% |
| | Production Development | Well Construction | 25% |
| | | Collection and Flow System | 40% |
| | | Stationary Production Unit | |
| | | Engineering | 40% |
| | | Mách. and Equip. | 40% |
| | Constr/Integr/ Assy | 40% | |

NEGATIVES

- The very detailed Local Content Table and the application of penalties are also topics highly contested by several stakeholders.
- Excessive levels of Local Content percentage requirements did not take into account the actual installed capacity in the country.
- This resulted in project execution delays and heavy fines for both the concessionaires and the suppliers.
- Some decisions lead to a level of protectionism that resulted in expensive prices and longer deadlines, higher than those on the international market.
- The need to determine requirements for activities that will occur 6, 8 or even 10 years in the future is an impossible exercise.
- It ignores relevant market variants, such as macroeconomic conditions, oil prices or the advent of new technologies.



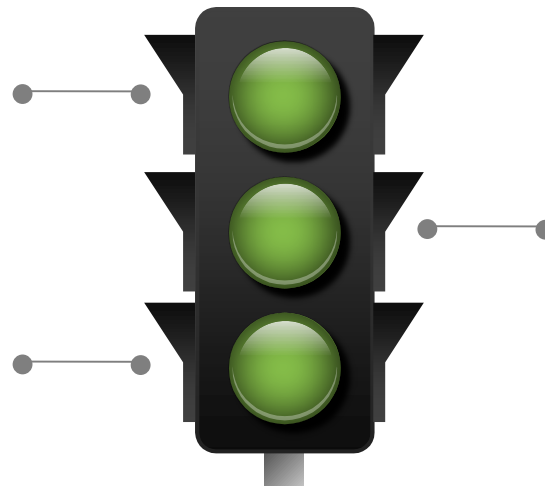
POSITIVES

- Overall, despite the difficulties presented over time, most of the policy's targets have been achieved.
- Several Brazilian service companies attained greater visibility, and by participating in more bids, the companies became more competitive in a global scenario.
- Capacity building also delivered positive results, as the demand for more jobs resulted in the training of skilled labor, and the higher academic qualification of professionals.
- The policy also brought the development of new technologies through investment in Research Centers in Brazil.



To promote a Market environment where suppliers have more than one buyer

To break down LC (engineering, goods, services) in the development plan



To bring together Industry, Government and Regulator to find common solutions based on rationality and market principals

To integrate LC within a larger all-encompassing industrial policy



THANK YOU!

nnarciso@nnfenergy.com.br

Mob.: +5521995158361

Office.: +552135793401