INFRASTRUCTURE AND ENERGY

ASSIGNMENT OF E&P CONTRACTS: POSSIBLE IMPROVEMENTS IN ANP RESOLUTION 785/19

22 NOVEMBER 2021

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After the publication of Law 9.478/97 (Petroleum Law) and with the advance of the granting of exploration and production concession contracts by the National Agency of Petroleum, Natural Gas and Biofuels (ANP), an extremely relevant market for transactions involving the purchase and sale of stake in exploration blocks and oil and natural gas fields opened in Brazil. These transactions involve not only the direct transfer of participation from one company to another, but also increasingly sophisticated project financing operations, with guarantees over the share control of concessionaires and over the emerging rights of these concessions.

Despite the relevance of the theme and the significant values involved, for many years the assignment of participation and the establishment of guarantees on exploration and production concessions was regulated only by a few clauses contained in the concession contracts and, more recently, in the production sharing contracts (both the E&P contracts).

To guide the agents, ANP also published, a few years ago, a basic instruction manual for the organization of documents and conduct of assignment proceedings before the agency, which has been updated periodically (Assignment Manual). For all aspects that were not addressed in the E&P contracts or in the manual, the market depended on the issuance of opinions prepared by the ANP for each specific case that, in its almost entirety, remained inaccessible to other companies.

Although the debate on the drafting of a specific regulation on the subject had existed for a long time, only from 2016 the subject gained traction, after a combination of factors. Among them, the progress in Petrobras' disinvestment process and a succession of crises in the sector that reinforced the need for greater clarity on the right of creditors in relation to the assets of insolvent operators.

In 2019, after three years of public consultations, ANP published Resolution 785/19, which, for the first time, established a legal framework for the assignment of participation and the creation of guarantees on E&P contracts.

This resolution created a level of legal certainty for transactions involving E&P assets and presented several regulatory advances, such as clarification of applicable guarantees on emerging rights and the non-obligation of an assignment process for changes of control that do not involve replacement of parent company guarantee (a topic not yet regulated in many other sectors).

However, as the reality of the facts is inevitably more complex than any regulation is capable of capturing, the practical application of Resolution 785/19 has demonstrated the need to deal with some issues in more detail, especially with regard to:

- characterization of the *de facto* assignment (*cessão de fato*);
- precise definition of rules on joint liability between transferor and transferee after assignment; and
- approval of new development plans in the assignment of mature fields.

In this article, we present comments on some of these topics.

I. Assignment in fact

Article 29 of the Petroleum Law provided for the possibility of transferring E&P contracts, always upon prior and express approval by the ANP, which is required to prove that the new operator has the technical requirements necessary to operate the concession. A few years later, ANP published Ordinance 234/03, fixing a fine of R$ 500,000 for any assignment of participation in E&P contracts held without the agency's prior consent – a practice that was called "de facto assignment" – because such assignment could constitute a fraud to the duty to bid and the obligations present in the Petroleum Law.

None of these rules clarified in detail what acts could be understood as a *de facto* assignment, a point of great relevance, since the assignment processes in the ANP usually take many months to complete and it is in the legitimate interest of buyers or creditors to ensure the good management of assets during this period. Historically, the opinions issued by the ANP attorney's office converged to define that the assignment would actually materialize in the exercise of management power over the assets by a third party before the approval of the ANP.

As of 2015, however, ANP began to expressly include in E&P contracts the prohibition of any kind of influence of the transferee over the operations of the contract prior to the approval of the assignment. That same limitation was replicated in Resolution 785/19, which expressly prohibits buyers or creditors from exerting any kind of influence over the management or operation of the E&P contract (Articles 6 and 22).

The prohibition eventually brought even more uncertainty to the sector, as buyers or funders are reasonably expected to exert some kind of influence on asset management, although indirectly and typically limited to requiring the operator himself to maintain the operation in accordance with the normal course of business and industry best practices.

This type of influence is usually reflected in the fixing of contractual clauses by which the operator voluntarily undertakes to observe certain operating parameters during the transition period, including certain obligations not to do so (*negative covenants*).

It is quite reasonable, for example, that the seller undertakes not to relinquish the concession area or even not to drill new wells or abandon wells in use during the transition period. It is also reasonable for the parties to define that the making of certain investments will depend on the prior approval of the creditor or buyer.

Whatever the scope, it is not possible to conclude that such agreements imply the exercise of the management of assets by third parties, since:

> they involve commitments that the operator voluntarily undertook to observe during the transition period (i.e. the agreement reflects the operator's own will); and

> such commitments do not prevent the operator from taking a certain action, only mean that, in case of non-compliance, funders or buyers will have the right to apply certain contractual remedies, such as fines, early termination or indemnification.

In other words, even if an operator contractually undertakes to make or stop making certain operations, those commitments do not represent an obstacle to the operator's management power, since, at the limit, it remains the sole attribution of that operator the decision whether or not to comply with such commitments and, as the case may be, to bear the agreed contractual remedies. Non-compliance does not generate, to any extent, the transfer of the management of operations to buyers or creditors, giving them only the right to apply the agreed contractual remedies.

Resolution 785/19, by generally prohibiting "any influence" of third parties on assets, ultimately creates a criterion that, if applied literally, would significantly prohibit the rights of buyers and funders to ensure that the seller maintains good management and preservation of assets.

It would therefore be of great importance to clarify which types of agreements or actions would actually be covered by the concept of undue influence adopted by Resolution 785/19, recognizing that there is an interest and a legitimate right of buyers and financiers to set, together with the operator, certain operational standards, provided that they are focused on the good management and preservation of assets. The adoption of vague criteria, such as the concept of "influence", ends up increasing the perception of risk and limiting the partnership and financing operations that could contribute to the development of the sector.

II. Joint Liability

The joint liability among partners of an E&P consortium (intra-consortium joint liability) is a widely debated and somewhat well-settled issue. On the other hand, the residual joint liability of parties that have already withdrawn from an E&P contract remains a controversial issue, especially because it lacks clear legal reasoning and greater detail in the regulation of the ANP.

It is important to note that the Petroleum Law deals solely with joint and several liability between companies that are part of an E&P consortium, with no reference to the joint liability of the transferor after the conclusion of the assignment of its participation in an E&P contract. In relation to the assignment procedures, the Petroleum Law only clarifies that the transfer of E&P contracts is allowed "provided that the new concessionaire meets the technical, economic and legal requirements established by the ANP". At no time did the law include any provision or condition requiring the transferor to maintain joint and several liability with the transferee.

The concept of joint liability between transferor and transferee arose only later, in the scope of the assignment clauses of E&P contracts. However, these provisions were rather vague, providing only that, in case of assignment, the "joint and several liability between transferor and transferee would be maintained in accordance with applicable legislation". It happens that, as stated before, there is no applicable provision in the legislation concerning joint liability between assignors and assignees.

Based on the provision of E&P contracts, the ANP began to demand, in the context of the assignment processes of participation in these contracts, that the Term of Assignment (document formalizing the transfer) would include express provision that the transferor would remain jointly and severally responsible with the transferee, without specifying the limits of such solidarity.

Resolution 785/19 represented the first opportunity in which the concept of joint liability between transferor and transferee came to be treated expressly in an infralegal norm. The resolution clarified that such joint liability is limited to obligations "constituted on a date prior to the transfer" and/or "resulting from activities carried out on a date prior to the transfer, even if constituted only at a later time". Although it seems obvious, such clarification has brought some minimal beacon on the limits of joint liability.

Despite the relative progress, Resolution 785/19 still fails to specify the legal basis of this joint and several liability or define fundamental issues to the concept, such as the type of obligations to which it refers, the scope of joint liability and the time limits.

It is not clear, for example, whether the ANP would be obliged to charge the current concessionaire first before recourse to the former concessionaire (order benefit). In a concession that has already had multiple dealers, it is also not informed whether the ANP should follow the chronological order of the assignments or whether it could charge the defaulted obligation of any of the former concessionaires.

Although it is an old theme, this uncertainty has taken even greater relevance with the maturing of the E&P industry in Brazil and with the heating of operations involving the sale of mature fields. Because these fields have a long history of operations, extensive infrastructure, and relevant abandonment liabilities, it is essential that operators interested in selling their stake know exactly what kind of residual liability they may still have after the transfer.

It is unreasonable for concessionaires who have already transferred their participating interest in a field many years ago to continue to monitor this field or maintain indefinite provisioning for as long as the E&P contract remains in effect.

Moreover, considering that the transferee is obliged to go through a strict process of technical, legal and financial qualification in the ANP before assuming the participation in the E&P contract (usually stricter than that originally required of the seller), it is to be questioned what would be the legal justification for the imposition of such joint liability. It is worth remembering that Resolution 785/19 also requires that the E&P contract be fulfilled at the time of assignment, which represents another prior control to reduce the relevance of solidarity.

In practice, more than ensuring the proper fulfillment of the E&P contract, the imposition of unrestricted joint liability of the transferors with the assignees ends up representing a double liability, without foundation in law, with requirements greater than those originally required by the ANP for the signing of E&P contracts.

The Petroleum Law correctly requires only that assignees submit to the same qualification criterion originally imposed for the signing of E&P contracts. there is no legal or logical justification for the former concessionaire to be responsible for that concession after the transfer.

Furthermore, it is important to note that such joint liability is imposed solely in processes of direct assignment of participation in the E&P contract. Thus, a company may choose to sell its stake in a given field through a simple change of control transaction, in which case there would be no change of concessionaire and therefore the former controller would have no remaining liability with respect to that E&P agreement.

Therefore, based on the current legal framework, in particular the Petroleum Law, it is not clear the reasons that justify the maintenance of the provision of joint and several liability between transferor and transferee. If the ANP chooses to maintain this provision, it would be essential that the logical reason becomes clearer and, at least, that basic issues inherent in this concept were clarified, such as:

> whereas the joint liability is subject to a benefit of order, so that the liability of former concessionaires is conditional on the absolute default of the current concessionaire; and
>
> that joint liability is subject to the statutes of limitation provided for in the legislation.

III. Development plan

In the context of sale of participating interest in mature fields, considering the sharp decline in production that these fields usually present, it is very important that the buyer has the ability to implement their production recovery project with the maximum possible agility. These projects, commonly called redevelopment, require the approval of a new development plan (PD) by the ANP, in a long process that often requires many months of information exchange between the operator and the agency.

Recognizing the importance of this issue, the Resolution 785/2019 brought an important innovation by predicting that, in processes of assignment of mature fields, the transferee could submit the new PD to the ANP even before the completion of the transfer, to be approved by the agency simultaneously with the assignment process.

Resolution 785/19, however, did not address the difficulty of reconciling the schedule of the two processes (assignment and approval of the PD), which regulatorily have very different approval deadlines. While an assignment process can be completed within 90 days, the approval of a PD can traditionally take more than six months. The divergence ends up limiting the full use of this mechanism, since transferors and assignees cannot ignore the risk of delaying the assignment process if they link it to a PD approval process.

Although it is a remarkable advance brought by Resolution 785/19, the lack of a better detail on the deadlines of this mechanism ends up making its use limited.

To avoid this problem, the simplest alternative would be to provide for a shorter period for the approval of PDs sent in the context of transfer proceedings in order to reconcile the time limit for the two cases.

Another simple solution would be to clarify that, in the use of such a mechanism, the transferee could choose to submit only a proposal for revision of the PD, containing the central elements of the field redevelopment project, and making it clear that the full review would be presented only after the completion of the assignment.

There are precedents in which the ANP has already approved this type of proposal in the context of processes to extend the validity of concessions, setting a deadline for the concessionaire to submit the complete revision of

the PD. This alternative would give the assignee greater security that his project will be approved by the ANP, while allowing a faster process.

CLARIFICATION OF THE ANP COULD SOLVE PROBLEM

It is important to note that most of the bases for the recommendations indicated above are already provided for in the regulation. Thus, a broad revision of Resolution 785/19 would not even be necessary. In practice, many of the recommendations could be implemented through the publication of mere clarification, as already adopted by the agency in relation to so many standards.

In the present case, it is emblematic that the Assignment Manual, referred to in the regulation itself, already act in this way, serving as a general regulation of the practical application of Resolution 785/19. Similar manuals can be found in several other ANP standards, such as the local content booklet (*cartilha de conteúdo local*) and incident reporting manual (*manual de comunicação de incidentes*). Therefore, the most practical solution would be to expand the Assignment Manual to include additional topics that address the topics mentioned above.