Latin America
Oil & Gas Handbook
2018
Latin America Oil & Gas Handbook - 2018

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A Message From Our Latin America Chair

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We are proud to provide you with the 4th editions of our 2018 Latin America Oil & Gas, Power, Mining and Infrastructure Handbooks. Each Handbook is a product of numerous contributions from our Latin American offices, to all of whom we extend our profound thanks for their time and expertise.

As investors keep Latin America as a primary region for growth, the Handbooks provide an overview of the most relevant laws and regulations in each of the 7 countries in Latin America where we are present: Argentina, Brazil*, Chile, Colombia, Mexico, Peru and Venezuela.

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We hope these guides are useful for your business.

José Roberto Martins
Chair, Latin America Energy, Mining and Infrastructure Practice*

*Through cooperation with Trench Rossi Watanabe, a Brazilian law firm
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Argentina

Argentina Upstream Industry

1. Industry Background

The hydrocarbons industry in Argentina has experienced different stages as from the first oil discovery in 1907. Such stages began with the state monopoly over hydrocarbons during the first decades, a process of deregulation peaking during the 90’s, and recently, acts of nationalization and major modifications to the National Hydrocarbons Law No. 17,319 (“Hydrocarbons Law”).

Argentina is a federal republic divided into 23 Provinces and the Autonomous City of Buenos Aires, which is the capital city of the country. Each Province enacted its own Constitution and regulatory framework and all powers not delegated to the Federal Government through the National Constitution remain in the Province.

Early developments in the industry were followed by the creation of Argentina’s first national oil company (“NOC”), YPF Sociedad del Estado (“YPF”) in 1922. YPF had the monopoly of oil and gas in the country and international and local private oil and gas companies (“O&G Companies”) had access to the industry mainly as YPF’s service providers. At this stage, the Federal Government constitutionally retained the jurisdiction and domain over Argentina’s hydrocarbons and the exploration, exploitation, manufacture, transportation and commercialization of oil and gas were regulated by the Hydrocarbons Law. The Hydrocarbons Law provided for the granting of concession-based rights with a possibility for NOCs (YPF) of entering into other types of agreements to explore and exploit hydrocarbons.

During the 90’s the industry was highly deregulated. Services agreements between YPF and O&G Companies were converted into exploitation
concessions, and in 1992 YPF was privatized by National Law No. 24,145 ("Privatization Law"). Therefore, YPF became a private company and its shares were gradually sold to private parties.

In 1994, the National Constitution was amended transferring the eminent domain over natural resources to the Provinces but no specific reference was made on the jurisdiction on those resources. This situation caused conflicts between the Provinces and the federal government over regulation in relation to natural resources. Many, but not all of such conflicts, were overcome in 2007 when National Law No. 26,197 (the "Short Law") was enacted transferring the granting and control authority of hydrocarbons to the Provinces.

Following -and in some cases before- the enactment of the Short Law, the Provinces enacted legislation or executed agreements regarding hydrocarbons, which, at times, could have seen as conflicting with or circumventing the provisions of the Hydrocarbons Law. In addition, hydrocarbons' producing Provinces have created their own provincial owned companies ("POC").

As the federal government lacked a NOC due to YPF’s privatization, and also lacked onshore areas due to the transfer made to the Provinces, in 2004 Law No. 25,943 was enacted ("ENARSA Law"), creating Energía Argentina S.A. (ENARSA), Argentina’s second NOC. ENARSA’s purpose is carrying out on its own or in association with private companies the exploration and production of oil and gas as well as industrialization, transport and trade of oil and gas and electricity. Although the federal government transferred to ENARSA the vacant offshore oil and gas reservoirs located within 12 to 200 nautical miles, few activity has been carried out in relation to hydrocarbons. ENARSA’s offshore areas were recently transferred again to the National Government (National Secretary of Energy) due to a modification of the Hydrocarbons Law as mentioned below.
As from 2002, the industry suffered many distortions (price caps, withholding taxes, subsidies, suspension of exports, imports of gas and fuel oil, etc.) due to governmental decisions aimed at protecting Argentina’s economy and addressing a growing energy crisis portraying a constant decrease in hydrocarbons’ production and reserves combined with an increase of demand.

In May 2012 the federal government enacted Law No. 26,741 (“Nationalization Law”) declaring that 51% of the shares of YPF and Repsol YPF Gas S.A. (“YPF Gas”) are subject to expropriation. Only the shares held by a Spanish company, Repsol, and related parties were expropriated. According to the Nationalization Law, YPF and YPF Gas will operate as private companies and YPF shall be entitled to seek internal and external financing, and sign joint ventures or other associative agreements with private, public, local, or foreign companies.

Law No. 27,007 was published in the Official Gazette on October 31, 2014, introducing major changes to the regulatory framework aimed at promoting the development of Argentina’s unconventional potential (“New Regime”). Some of those changes include: (i) less relinquishment obligations; (ii) possibility to hold areas for more years and unlimited term extensions; (iii) current holders of areas can access non conventional concessions without public bids; (iv) limit to the royalties to be paid; (v) the Provinces and the National Government shall not be entitled to reserve vacant areas in favor of NOC’s or POC’s; (vi) elimination of the “carry” provision included mostly in agreements between POCs and O&G Companies during the “development” stage; (vii) the areas that were assigned to ENARSA in 2004 shall revert to the National Secretary of Energy, who shall grant permits and concessions according to the New Regime; (viii) royalty reduction under certain circumstances; etc.

Recently, in 2017 ENARSA was merged with Emprendimientos Energéticos Binacionales S.A. another company wholly-owned by the federal government and aimed primarily to trade energy obtained from binational
hydroelectric exploitations and to develop projects and other activities related to hydropower-, in order to become Integración Energética Argentina S.A. (IEASA). The objectives of the company are to: (i) develop the offshore areas; (ii) exploit and commercialize oil and gas; and (iii) participate in the generation, transmission and trade of power. However, IEASA’s main activity has been the importation of liquefied natural gas (LNG) for its regasification and injection in the local pipeline systems.

In the recent years, Argentina has been identified as having great potential for unconventional horizons, specifically, as having one of the world’s major reserves of shale gas in the so called “Vaca Muerta” formation. This situation has generated positive expectations in the industry. Such reserves are located in the central west part of Argentina in the Neuquina basin, which includes the Provinces of Neuquén, La Pampa, Río Negro and Mendoza. In this sense, many areas were granted to O&G Companies in association with POC, and many associations between companies already holding concessions in that area and O&G Companies have been closed. In July 2018 it was announced the construction of a new railroad system from Vaca Muerta to the port of the City of Bahía Blanca (Province of Buenos Aires) reducing the costs by 50%. The call for bids is expected for the fourth quarter of 2018 and the awarding will take place in April 2019. The execution of the Construction Agreement is expected for May 2019.

As per offshore development, in July 2018 the federal government will call for bids to award exploration and exploitation permits in the Argentinean Off-Shore. This bidding round, named “Argentina Offshore Bidding Round 7”, is for the following blocks: (i) Austral (6 blocks, from 2,000 Km2 to 2,500 Km2); (ii) West Malvinas (30 blocks from 3,000 Km2 to 5,000 Km2); and (iii) northern portion of Argentina Basin Area (14 blocks, from 6,300 Km2 to 8,800 Km2). Offers have to be submitted by November 2018 and the award is expected to take place in December 2018.
2. **Legal Framework**

2.1 **National Laws**

The Argentinean oil and gas industry is regulated by the following principal national laws:

(a) Hydrocarbons Law, which was amended by the Short Law and the New Regime, establish the general legal framework for the exploration and production of oil and gas (upstream). These national laws must be followed by the Provinces, but since 2007 (when the Short Law was issued) each Province has been granted the authority to: (i) appoint the enforcement authority; (ii) grant exploration permits, exploitation concessions and agreements; (iii) collect royalties, (iv) control and supervise the permits, concessions and agreements; (v) require the fulfilment of legal or contractual obligations in connection with investments, rational exploitation of resources, information and rentals and royalties’ payment, and (vi) grant extensions to exploitation concessions or agreements, and to determine sanctions.

The authority of the Provinces includes not only the on-shore deposits but the off-shore deposits located up to twelve nautical miles from the shore. The Federal Government has the authority to establish the national energy policy (e.g., the guidelines on oil and gas activities) having the Provinces the obligation to follow such guidelines.

(b) Privatization Law, which privatized YPF and provided for the transfer of hydrocarbon reserves from the National Government to the Provinces subject to and preserving the rights of the existing holders of exploration permits and exploitation concessions.
Transportation, storage, distribution and commercialization of gas are mainly regulated by Law No 24,076 ("Natural Gas Law"). Natural gas transportation concessions are granted for 35 years and can be extended for 10 additional years.

The Natural Gas Law establishes a division among producers, transporters and distributors and therefore, the following restrictions: (i) gas transporters cannot buy or sell gas; (ii) gas producers, gas warehousing managers and gas distributors and their controller and controlled companies cannot have a major equity participation in gas transportation companies; and (iii) gas brokers cannot have a major equity participation in gas transportation and gas distribution companies.

Natural gas shall only be transported by commercial companies and ENARSA (currently IEASA) upon the granting of the relevant licenses, concessions or permits. If the public bid to grant such licenses fails, the government shall be entitled to transport and distribute gas.

Exports of natural gas are subject to the prior approval by the national competent authority. Currently, exports can only be made after domestic demand is satisfied. Natural gas exports are also subject to the export withholding duty.

ENARSA Law, which created ENARSA, Argentina’s national oil and gas company. ENARSA is accountable to the federal government, specifically to the Ministry of Federal Planning, Public Investment and Services (Ministerio de Planificación Federal, Inversión Pública y Servicios). As it was explained above, ENARSA was merged with Emprendimientos Energéticos Binacionales S.A., in order to become Integración Energética Argentina S.A. (IEASA).
(e) Nationalization Law, whereby the federal government nationalized 51% of YPF’s shares.

(f) On July 15, 2013 the National Government issued Executive Order No. 929/2013 creating a new Hydrocarbons Promotional Regime (the “Promotional Regime”). The Promotional Regime is a framework under which the federal government, through YPF, is expecting to increase investments to develop Argentina’s unconventional potential. As indicated above, YPF recently entered into an agreement with Chevron to accomplish such goal.

Companies holding exploration permits or oil concessions, or third parties associated with such holders shall be eligible for the Promotional Regime. Those companies must file an “Investment Project for Exploitation of Hydrocarbons” (the “Project”) that shall involve a direct investment in foreign currency of not less than US $1,000,000,000 to be invested during the first five years of the Project. The Project shall be filed with a specific agency which shall indicate all filing and approval requirements.

The benefits of the Promotional Regime are: as from the fifth year of the execution of the Project, registered companies shall enjoy: (i) the right to export 20% of the hydrocarbon production derived from the Project with 0% export withholding duty; and (ii) the right to freely dispose of funds derived from those exports, with no obligation to repatriate that foreign currency.

However, if Argentina’s internal production of energy is not sufficient, companies entitled to the above mentioned benefits shall be entitled to receive in consideration for the 20% above mentioned, a price not lower than the export reference price without taking into account the deduction of the export withholding duty. That is to say, hydrocarbons shall be sold to the local market and the Government shall guarantee the difference
(in Pesos) between the local market price and the export price. In addition, Government shall grant those companies a “priority right” to access the foreign exchange market to purchase US dollars for the price collected for that 20% and for the difference to be paid by Government.

Companies included in the Promotional Regime shall be entitled to request a non-conventional exploitation concession (applicable to non-conventional reservoirs), which shall be granted within the existing hydrocarbons exploration permit and exploitation concession but for a 25 year term to be counted as from its granting.

In that sense, the corresponding authorities shall divide the area covered by the existing right and grant a non-conventional exploitation concession for 25 years and the possibility to add, simultaneously and in advance, a 10-year extension. The area of the existing conventional right not covered by the non-conventional exploitation concession shall remain valid under the same pre-division terms. Holders of a non-conventional exploitation concession also holding an adjacent and preexisting conventional exploitation concession shall be entitled to request their unification as one non-conventional exploitation concession as long as they may evidence the geologic continuity of the reservoir beneath them.

The New Regime incorporates the following new promotional measures to the Promotional Regime explained in (f) hereinabove: new investments approved by the National Government that contemplate expending at least US$ 250,000,000 during the first 3 years of the project (“New Investment Projects”) shall be entitled to: (a) as from the third year, free disposal of production with no export duties, and full access to the foreign exchange market for: (i) 20% of conventional production; (ii) 20% of unconventional
production; and (iii) 60% of offshore production; and (b) beneficial import duties in relation to certain key equipment to be affected to these projects. The New Investment Projects, will contemplate 2 contributions to the Provinces: (a) 2.5% of the initial investment amount to be contributed by the corresponding company will be allocated to Social Responsibility; and (b) an amount to be determined taking into consideration the size of the project, to be contributed by the National Government for the financing of infrastructure projects.

2.2 Provincial Laws

The oil producing Provinces have been enacting their own hydrocarbons laws and regulations which are similar to the Hydrocarbons Law, and empower their own enforcement authorities. In addition, Provinces have created POCs to explore hydrocarbons reserves in association with private parties.

3. Major Industry Players

The major oil company in Argentina is YPF. Although there are other relevant players in the industry as Petrobras, Panamerican Energy and Total, YPF is a fully integrated company with presence in exploration and production (“E&P”), midstream and retailing throughout the country. YPF was originally created as Argentina’s NOC having oil and gas monopoly, it was privatized during the 90’s and recently partially nationalized. In this sense, the role of the company in the oil and gas industry is being expanded with the government control.

YPF was created in June 3, 1922. After years of state ownership and management, YPF started in 1991 a privatization process, selling many of its assets (refineries, pipelines, and oil fields).
In 1999, Repsol -a Spanish corporation- purchased 98% of YPF. The union of the two companies was denominated Repsol - YPF. In 2007, the Petersen Group -an Argentine company- acquired a 15% stake in YPF; and afterwards, in 2011, the same group bought an additional 10%. A majority of the firm’s shares (58%) remained under the control of Repsol, 16% in private portfolios; and the Argentine government retained a golden share.

During 2010, consortiums led by YPF were awarded most of the areas offered in the Province of Neuquén for the exploration of hydrocarbons in association with Neuquén’s POC (Gas y Petróleo del Neuquén). Such areas have been deemed as having great non conventional horizons’ potential.

In May 2012, the Argentine government enacted the Nationalization Law deciding the nationalization of 51% stake in YPF held by Repsol. The National Government will control 51% of such package and ten provincial governments will receive the remaining 49%.

YPF has recently entered into an agreement with Chevron to develop unconventional reservoirs in the Province of Neuquén and is negotiating with other companies to achieve the same. The Chevron agreement is based in the Promotional Regime (see Section 2.1(g) above), includes investment obligations by such company, but also privileges in exchange for such investments due to Argentina’s government need to develop unconventional hydrocarbons’ potential in Vaca Muerta. Recently, YPF has also signed memorandums of understanding to develop certain areas of Vaca Muerta with Sinopec (China) and Petronas (Malaysia).
### 3.1 Relationship among the Government, NOC, POCs and O&G Companies

<table>
<thead>
<tr>
<th>State Owned Company</th>
<th>O&amp;G Companies’ Role</th>
<th>Granting Capacity</th>
<th>Privileges</th>
</tr>
</thead>
<tbody>
<tr>
<td>POC</td>
<td>One or various O&amp;G Companies have executed granting documents in association with the corresponding POC.</td>
<td>Provinces.</td>
<td>POCs may have veto rights in relevant operative decisions. POCs’ participating interest can’t be diluted and, therefore, they can’t be excluded from the agreements.</td>
</tr>
<tr>
<td>YPF</td>
<td>YPF is currently associated with O&amp;G Companies in various areas of Argentina.</td>
<td>YPF currently holds E&amp;P rights solely and also associated with POCs and O&amp;G Companies.</td>
<td>YPF is in a privileged situation as it is the holder of most of the areas with unconventional potential in the Province of Neuquén.</td>
</tr>
</tbody>
</table>
4. **Acquiring E&P Rights**

4.1 **Licensing Rounds**

The Hydrocarbons Law establishes public bidding procedures as the system to award E&P rights. The New Regime that amended the Hydrocarbons Law indicates that vacant areas shall be offered to private parties through public bids based on uniform bidding terms that the Provincial and National authorities should draft within 6 months as from the effective date of the New Regime. Such uniform bidding terms have not been issued yet.

There are no limitations on the nationality of the holders of E&P rights; nevertheless, any applicant must register a domicile in Argentina, have the required technical and financial capabilities, and fulfill any other condition set forth in each bidding process.

4.1.1 **Concession based E&P rights**

The Provinces and the federal government (depending on the location of the area) are entitled to grant E&P rights through a bidding process to any individual or entity. The awardee/s will be the company or group of companies that make the highest investment offer and will be considered as the title holder of the corresponding E&P right.

The E&P rights under the Hydrocarbons Law are:

(i) **Exploration Permits**

Under an exploration permit its holder is entitled to explore, construct the required infrastructure and have a preference to exploit the area if a commercial discovery is achieved. Rental and royalties must be paid, and committed investments must be completed during the different stages of the exploration.
The exploration terms will be determined in each bidding taking into consideration the exploration target with the following maximums for the Basic Period:

- **Conventional Exploration Target:**
  - 1st stage, up to 3 years
  - 2nd stage, up to 3 years

- **Unconventional Exploration Target:**
  - 1st stage, up to 4 years.
  - 2nd stage, up to 4 years.

For conventional exploration on the Territorial Sea and Continental Platform (offshore), each stage of the Basic Period may be increased up to 1 year.

Extension Term for conventional and non-conventional exploitation: up to 5 years

(ii) **Exploitation Concession**

Under an exploitation concession, its holder is entitled to exploit the area, extract the hydrocarbons, build and operate the required facilities and obtain a transportation concession. Permit holders and concessionaires have the right to request and non-conventional exploitation concession either by (i) declaring a commercial discovery, (ii) converting their current conventional exploitation concession, or (iii) by merging a non-conventional concession with an adjacent conventional concession.

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1 The Continental Platform reaches up to 200 nautical miles and is under the jurisdiction of the National Government except for the Territorial Sea that reaches up to 12 nautical miles from the shore and is under the jurisdiction of the Provinces.
Rental, royalties and taxes must be paid, and committed investments must be completed.

- Exploitation concession term:
  - Conventional Exploitation: 25 years.
  - Unconventional Exploitation: 35 years.
  - Exploitation in the Continental Platform and Territorial Sea: 30 years.

- Extension: The holders of exploitation concessions can request indefinite 10-year extensions provided they comply with their obligations as concessionaires and with the requirements indicated in the NHL.

(iii) Transportation Concession

Transportation concession will be granted and extended for terms equivalent to those of the corresponding associated exploitation concession. Once such terms expire, the transportation facilities shall revert to the National or Provincial Government.

4.1.2 E&P contractual rights

There was another system that consisted of the Provinces or de National Government (depending on the location of the areas) reserving areas in favor of NOCs and POCs for them to call for bids for the granting of E&P contractual rights.

In this sense, the New Regime that amended the Hydrocarbons Law indicates that the Provinces and the National Government shall not longer be entitled to reserve vacant areas in favor of NOCs and POCs.
In the case of the areas already reserved to NOCs and POCs and the contracts signed between such companies and O&G Companies, such situations shall remain under the same terms. In case of areas already reserved to NOCs and POCs that have not signed association agreements, such agreements should indicate that the participation of the corresponding NOC or POC during development stage will be proportional to the investments they effectively make. In other words, the “carry” included mostly in agreements between POCs (e.g., Gas y Petróleo del Neuquén) and O&G Companies, whereby the latter funded the operations of the POCs, will no longer be permitted during the “development” stage.

4.1.3 Private Transactions

Private transactions to acquire E&P rights such as sale of shares or assets are valid in Argentina. In the latter case, the acquiring/assignee party will most likely have to be approved by the corresponding enforcement authority.

Argentina’s non-conventional horizons potential, specially in the Province of Neuquén, has generated the execution of transactions of farm-in / farm-out whereby private companies holding exploitation concessions have associated with other oil companies with expertise in such exploitation techniques.

4.1.4 Restrictions to Operate

There are certain restrictions and sanctions indicated in Law No. 26,659 as amended by Law. No. 26,915 ("Law"), and Resolution 407/07 of the National Secretary of Energy (the “Resolution”), applicable to whoever performs oil & gas activities in the Argentine offshore Continental Platform, without the authorization of the Argentine Government.

In practice, the only area of that Continental Platform where companies may operate without the permit of the Argentine Government is the Malvinas or Falkland Island or Malvinas Islands area ("Malvinas Area") as
there is a current sovereignty issue over such islands between Argentina and the United Kingdom. The Law and Resolution do not refer to the Malvinas Area specifically, but the intention is to sanction companies operating there.

4.2 Granting Instruments

As mentioned in Section 4.1 above, the New Regime that amended the Hydrocarbons Law indicates that uniform bidding terms should be issued within 6 months as from the effective date of the New Regime, but such bidding terms have not been issued yet.

4.3 Seismic Permits

At a National level, seismic permits for surface recognition activities are regulated by Sections 14 and 15 of the Hydrocarbons Law. According to Section 15 those interested in performing these activities shall obtain an approval of the corresponding authority.

These permits are granted over an specific area and are not exclusive to the applicants, although they can request for as many permits as they desire. Argentinean and foreign individuals and legal entities (either public or private) can qualify as applicants.

These Hydrocarbons Law provisions apply to off-shore areas under National jurisdictions (beyond 12 nautical miles from the coast) and also to the territories under Provincial jurisdiction (onshore and off-shore up to 12 miles from the coast). Thus, the granting authority would depend on the location of the relevant areas.

The proceeding to obtain these permits was regulated by Resolution 131 of the Energy Secretariat. On May 15, 2018, Resolution 197/2018 of the Ministry of Energy and Mining was issued specifically for off-shore areas including a permitting model consistent with multi-client survey. Among others, this new resolution has extended the term of these permits (8
years); the term of exclusivity to market the surveyed data extends throughout the term of the permit plus 2 years since its expiration; when a foreign entity applies for these permits it shall be jointly and severally liable together with the controlled company/subsidiary; and applicants shall prove an experience of at least 5 years in this activity.

5. **Government Takes**

<table>
<thead>
<tr>
<th>Government Take</th>
<th>Rate</th>
<th>Payment Base</th>
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<tbody>
<tr>
<td>Royalties</td>
<td>Concessionaires shall pay 12% royalty on their production of liquid hydrocarbons and natural gas. That royalty may be reduced to 5%, considering productivity, condition and location of the wells. In case of term extensions, the additional royalty shall be of up to 3% applicable to the first term extension, and up to 18% for the following extensions.</td>
<td>Royalties are calculated on the value of the hydrocarbons “at the well” as determined monthly by permit holder or concessionaire less the corresponding transportation costs. The enforcement authority will be able to challenge it if it considers that such value does not reflect the real market value.</td>
</tr>
<tr>
<td>Government Take</td>
<td>Rate</td>
<td>Payment Base</td>
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<tr>
<td><strong>Canon or Rental Fee</strong></td>
<td>The holder of an exploration permit shall pay, annually and in advance, for each km² or fraction thereof, the following:</td>
<td>Depends on the extension of the area.</td>
</tr>
<tr>
<td></td>
<td>• <strong>Basic Term:</strong></td>
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<td></td>
<td>o 1st. stage, AR$ 250.</td>
<td></td>
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<tr>
<td></td>
<td>o 2nd. stage, AR$ 1000.</td>
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<tr>
<td></td>
<td>• <strong>Extension:</strong></td>
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<tr>
<td></td>
<td>o During the first year: AR$ 17,500 km² or fraction thereof, increasing that amount 25% annually.</td>
<td></td>
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</tbody>
</table>

In addition, the holder of an exploitation concession shall pay annually and in advance, for each km² or fraction thereof: AR$4,500.
<table>
<thead>
<tr>
<th>Government Take</th>
<th>Rate</th>
<th>Payment Base</th>
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</thead>
<tbody>
<tr>
<td>Fee to the Owner of the Land</td>
<td>Indemnification agreements with surface owners must entered into or, if an agreement with the respective surface owner(s) is not reached, apply to the relevant authority for an easement to access the subsurface land.</td>
<td>N/A</td>
</tr>
<tr>
<td>Bonus Payment</td>
<td>For the granting of extension of Exploitation Concessions, and (ii) in relation to complementary conventional exploitation activities under a non conventional exploitation concession.</td>
<td>Basically, it shall result from multiplying the proven remaining reserves per 2% of the basin average price applicable to the hydrocarbons during 2 years.</td>
</tr>
<tr>
<td>NOCs / POCs Participation</td>
<td>Please refer to Section 4.1.2 above.</td>
<td>N/A</td>
</tr>
<tr>
<td>Investment Plan</td>
<td>Companies must offer an amount of investments that they Yearly allocated according to the exploration/exploitation</td>
<td></td>
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<tr>
<td>Government Take</td>
<td>Rate</td>
<td>Payment Base</td>
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<tr>
<td>are willing to perform in the corresponding area.</td>
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<td>on term.</td>
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<tr>
<td><strong>Federal Taxes</strong></td>
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<tr>
<td></td>
<td>Main federal taxes are:</td>
<td>N/A</td>
</tr>
<tr>
<td></td>
<td>(i) Income Tax (35%);</td>
<td>(i) Applied on net income.</td>
</tr>
<tr>
<td></td>
<td>(ii) Value Added Tax (21%);</td>
<td>(ii) Applied on the value of goods or services.</td>
</tr>
<tr>
<td></td>
<td>(iii) Minimum Presumed Income Tax (1%);</td>
<td>(iii) Applies taking into consideration the value of assets.</td>
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<tr>
<td></td>
<td>(iv) As from 2002, the federal government imposed withholding export duties on oil exports.</td>
<td>(iv) When the Brent price is: (a) less than US$ 71/bbl., an export duty of 1% applies; (b) equal or higher than US$ 71/bbl. a polinomic formula applies.</td>
</tr>
<tr>
<td><strong>Provincial Taxes</strong></td>
<td>(i) The Gross Receipt Tax applies at a rate that, in general, does not exceed</td>
<td>(i) Applies to gross receipts of commercial activities at a rate that vary</td>
</tr>
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</tbody>
</table>
Government Take | Rate | Payment Base
--- | --- | ---
3%. | depending on the jurisdiction.
(ii) Stamp tax is a documentary tax at a rate that varies from 1 to 4%. | (ii) Applies to the value of the agreement. The rate varies depending on each Province.

6. **Procurement of Goods and Services**

6.1 **Procurement by Public and Government-Controlled Entities**

Public agencies’ general procurement requirements include the registration of the goods or service provider in the registry of state providers and compliance with the provisions of the applicable contracting procedure (direct purchase, private bidding, and public bidding).

Also, “buy national requirements” apply to Governmental Entities, State Owned Companies and Public Services Concessionaries whereby, with certain exceptions, they are obliged to grant preference to national goods and services over foreign ones; if the price is reasonable (reasonable price and nationality are defined in the regulations according to specific criteria).

Please note that the Province of Neuquén, has enacted a “buy local” regime applicable to O&G Companies whereby they would be obliged to grant preference to local goods and services.
6.2 Local Content Policy

Under the Hydrocarbons Law, companies holding exploration permits and/or exploitation concessions must hire at least 75% of local employees. Similar principle and percentages are included in provincial regulations (e.g., Province of Neuquén). The operator may be exempted from complying should no qualified personnel are available.

6.3 Special Tax Regimes

There are no special tax incentives applicable to procurement of domestically manufactured goods and services for the upstream industry.

7. Environmental Liability

From an environmental point of view, specific authorizations in respect of the different stages of development (exploration, production or transportation) are required. For each stage a different environmental impact study must be made and periodically updated. According to the activities being performed in the areas, O&G Companies must apply for specific permits or authorizations, or be registered with provincial and federal agencies to carry out such activities complying also with the applicable environmental regulations.

Natural Gas Exploration, Development Production

E&P activities in relation to natural gas are governed by the same set of rules applicable to oil.

[Revised as of July 2018]
Brazil

Brazil Upstream Industry

1. Legal Framework

The Brazilian petroleum industry has significantly evolved over the past decades. The main events that affected the country’s legal framework were the enactment of (i) Constitutional Amendment # 9/1995, which allowed private companies to engage in E&P activities (the "1995 Constitutional Amendment"), (ii) Law # 9,478/1997 (the "Petroleum Law") and, more recently, (iii) Laws # 12,276/2010, 12,304/2010, 12,351/2010 and 12,734/2012 (the “Pre-Salt Rules”).

As determined by Article 177 of the Federal Constitution of 1988, from 1953 to 1997 all oil and gas exploration and production activities were performed by Petróleo Brasileiro S.A. – PETROBRAS1 (“PETROBRAS”). During this period, players supplied goods and services to the Brazilian oil and gas industry as PETROBRAS contractors.

To attract private investors to the Brazilian market, on November 10, 1995, the Brazilian Congress enacted the 1995 Constitutional Amendment, which amended Article 177 allowing the Brazilian Government to also contract private companies to perform the activities comprised within the Federal Government’s monopoly.

The enactment of 1995 Constitutional Amendment was the turning point from which a variety of changes were introduced in the national petroleum sector, the most important of which occurred on August 6 1997, when the Brazilian Congress regulated the aforementioned Amendment # 9 by enacting Petroleum Law.

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1. PETROBRAS was created in 1953 by Law # 2,004 of October 3, 1953.
Among other important changes, the Petroleum Law established the Brazilian energy policy, regulated activities comprised within the Federal Government oil and gas monopoly, created the National Council of Energy Policy (“CNPE”) and the National Petroleum Agency (“ANP”).

The CNPE is a council linked to the President of Brazil and chaired by the Minister of Mines and Energy, whose responsibilities involve proposing to the Executive Branch the national policy for the energy industry. The ANP is the federal regulatory agency in charge of contracting, regulating and inspecting Brazilian oil and gas sector.

The Petroleum Law confirms the Federal Government monopoly over exploration and production activities and further states that these activities may be carried out – upon concessions or authorizations –, by companies incorporated under Brazilian law, with head offices and administration in Brazil. There is no legal restriction whatsoever as to the nationality of the quotaholders/shareholders of these companies, meaning that foreign companies are free to establish subsidiaries or branches in Brazil to engage in oil and gas exploration and production activities.

In 2009, Law # 11,909 (known as Gas Law) was enacted to regulate the article 177 of the Federal Constitution concerning the transportation, processing, storage, liquefaction, regasification and commerce of natural gas. The text determined that ANP shall regulate the relationship between the players which perform activities in gas market to ensure the open access to the gas transportation infrastructure, as well as guarantee the fair payment to the owners and operators of the gas pipelines.

Since then, ANP issued related resolutions such as #44/2011 (Public Utility Statements); #50/2011 (Operation of Liquefied Natural Gas Terminals); #51/2011 (Self Producer and Self Importer); 35/2012 (regulates the open access by interested third parties to gas pipelines with extension greater than 15 kilometres) #15/2014 (Criteria for Tariffs for Transport); #39/2014 (Bidding Procedures); #52/2015 (Building and Operation for Transport
Facilities); #11/2016 (Gas Swap Regulation); and more recently # 716/2018 (regulates the open access by interested third parties to gas pipelines with extension inferior than 15 kilometres).

Following the discovery of the pre-salt province, the Brazilian government started to re-evaluate the country’s E&P legal framework.

In 2010, Law # 12,351 (the “Pre-Salt Law”) came into force and introduced a production sharing system for the exploration and production of hydrocarbons located at the pre-salt polygon and strategic areas. Based on the original wording of the Pre-Salt Law PETROBRAS would be the mandatory operator of all pre-salt and strategic areas offered under the production sharing regime. However, in 2016 Law # 13,365/2016 was enacted, replacing PETROBRAS’s mandatory operatorship for a right of first refusal.

In what regards to unconventional oil and gas resources, Brazil’s potential has not been analysed in detail to date, but according to initial studies from the ANP shale gas deposits could even exceed the pre-salt gas reserves. In November 2013, ANP has promoted the 12th Bid Round, when 240 blocks were offered, including shale prone areas.

In April 2014, ANP enacted the Resolution No. 21/2014 which sets forth the technical and environmental requirements to be fulfilled by the concessionaires authorized to explore and produce unconventional resources of natural gas using the horizontal fracking technique.

Even though Brazil’s potential for unconventional resources seems promising, there are significant environmental, infrastructure and legal challenges to be overcome, including several Civil Public Actions that intend to declare null the effects of the 12th Bid Round, in which shale-

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2 Strategic Areas are those: of interest for national development, delimited by an act of the Executive Branch, characterized by low exploratory risk and high potential for production of oil, natural gas and other fluid hydrocarbons.
prone areas in Parana, São Paulo, Bahia and Piauí were awarded to concessionaires. Currently, all courts accepted the injunctions requesting for the suspension of the exploration activities.

Also, it is worth mentioning that in December 2013, a bill of law (No 6904/2013) was presented in the Brazilian House of Representatives, which would hamper any kind of shale gas exploration for five years. The bill of law is still pending to be voted by the Brazilian Congress, but the idea is to give room for further research on the feasibility of the exploration of shale gas in Brazil.

2. Major Industry Players

The Petroleum Law has also revoked Law # 2,004/53, which created PETROBRAS. PETROBRAS is now governed by the Petroleum Law (and by its Bylaws), which provides that PETROBRAS shall perform its activities on a free-competition basis, meaning that its position in the market shall be levelled to the position of private investors engaged in E&P activities in Brazil.

Be that as it may, PETROBRAS is still the major petroleum company in Brazil, with dominant presence in E&P, midstream and downstream activities throughout the country. Since the enactment of the Petroleum Law, however, various bid rounds have been promoted by the ANP and several International Oil Companies (“IOCs”) and Brazilian independent companies have acquired E&P concession rights in the country.

2.1 Relationship among the Government, NOC and IOCs

As mentioned above, until 1995 the activities comprised within the Federal Government monopoly over exploration and production of hydrocarbons were exclusively performed by PETROBRAS. However, after the enactment of the 1995 Constitutional Amendment and of the Petroleum Law, PETROBRAS’ position in the Brazilian oil and gas industry has suffered important changes. Since 2000, E&P rights began to be granted through
public and transparent bidding processes, in which PETROBRAS and all other companies participated on a free-competition basis.

Nevertheless, the Petroleum Law established a one-year period during which PETROBRAS could apply for the retention of areas where a commercial discovery was made or where the company had previously made significant investments in exploratory activities. As such, in 1998 the government promoted the so-called Bid Round 0 to ratify PETROBRAS’ rights over such areas.

Under the concession regime, the bidding rounds are launched by the Federal Government through the ANP, which is responsible for granting E&P rights as well as regulating and inspecting the activities performed by the oil & gas companies. After the bidding process is completed, the winner shall execute a Concession Agreement with the Brazilian Government. IOC’s are entitled to execute such agreement provided that a subsidiary is constituted in Brazil. In case that two or more offers are considered equal by ANP, the bid shall be decided in favour of PETROBRAS, only when the state-controlled entity is not in consortium with other companies.

On the other hand, under production sharing regime, the Ministry of Mines and Energy is empowered to execute the productions sharing contracts with mandatory consortium formed by PPSA, the company that wins the bid and, potentially, PETROBRAS, whenever it exercises its right of first refusal to be the operator of the relevant block, with a minimum 30% participating interest.

3. Acquiring E&P Rights

3.1 Licensing Rounds

Companies interested in acquiring the rights to explore for, develop and produce petroleum in Brazil must undergo a transparent and public
bidding process, whose rules are defined in the Petroleum Law, the Pre-Salt Law, the ANP regulation, and in the applicable bid invitation, which is published before the start of the bidding procedure. The bidding rounds will be under the concession or productions sharing regime, depending if the areas to be awarded are within the pre-salt polygon or strategic areas or not.

3.1.1 Concession Regime

The Brazilian concession regime has evolved since it began in 1997. All companies interested in acquiring rights to explore, develop and produce hydrocarbons in areas outside the pre-salt and strategic areas must participate in a transparent public bidding process. The rules of this process are defined either by the Petroleum Law, by the applicable bid invitation or by other associated regulations.

Companies interested in participating in the bidding round must enrol by submitting the documentation provided under the bid invitation, which usually includes: corporate documents, power of attorney for accredited representative, proof of payment of participation fee, confidentiality agreement, organizational chart of the corporate group and statement of compliance with qualification requirements. For foreign companies additional documents must be submitted for the enrolment: (i) evidence that the company is duly incorporated under the laws of the relevant country; and (ii) a commitment to incorporate a Brazilian subsidiary if the company wins the bid.

Once enrolled to participate in a bidding round, a company may elect to bid individually or jointly with other qualified companies. In joint bids, the group of companies awarded a concession must organize a consortium (i.e., a non-incorporated joint venture). In any event each member of the consortium must enrol to participate in the bidding round individually.
The winning companies must submit to the ANP the qualification documents specified in the bid invitation, which aim at qualifying companies technically, legally and financially for the performance of E&P activities. Again, each consortium member must qualify individually, but specific requirements apply to operators and non-operators.

If a foreign company is awarded with a concession, it must organize a Brazilian subsidiary or branch, with head office and administration in Brazil, prior to executing the respective concession agreement (Petroleum Law, Article 5).

By analysing the offers presented by the interested companies the ANP will identify the most advantageous, according to objective criteria established in the applicable bid invitation, observing the principles of legality, impersonality, morality, publicity, and equality among the bidders.

The scoring of points to each bid is the sum of points/weights assigned to each evaluation factor.

During the first bidding rounds, the formula used by the ANP for such evaluation took into account only two (2) factors: (i) signature bonus, equivalent to eighty five percent (85%); and (ii) concessionaire’s commitment to acquire local goods and services (“Local Content”), equivalent to fifteen percent (15%).

At Brazil Round 5 and 6, the weight of the Local Content has increased from fifteen percent (15%) to forty percent (40%), the minimum work program, which is proposed by the concessionaire based on the “Work Units” criteria defined by the ANP, was introduced as an additional evaluation factor, weighting thirty percent (30%) on the Agency’s evaluation of each tender, while the signature bonus’ weight was reduced from eighty-five percent (85%) to thirty percent (30%).
From Brazil Round 7 to 13, the weight percentage of each judgement factor was changed as follows: (i) 40% signature bonus; (ii) 20% Local Content; and (iii) 40% Minimum Work Program.

Recently, ANP has changed the judgment system for the concession regime. Since Brazil Round 14 (2017), the ANP excluded the Local Content as a judgment criteria, remaining as follows: (i) 80% signature bonus; (ii) 20% Minimum Work Program.

The chart below depicts the evolution of the judgment criteria adopted by the ANP for Brazil Rounds 1 to 14:

3.1.2 Production-Sharing Regime

The production sharing regime is restricted only to the pre-salt area, as geographically defined by the Pre-Salt Law, and to other strategic areas, which are tied to special interests for national development and shall be determined as such by the Executive Branch. Blocks not comprised within the pre-salt and the strategic areas, shall be subject to concession agreements awarded in accordance with the Petroleum Law.
The Pre-Salt Law specifies that the rules to be followed by ANP for the bidding process shall include the publication of invitations to bid, the submission of a draft production sharing contract (“PSC”), the indication of the bidding judgment criteria and other information necessary for the performance of the bidding process. The winning bid shall be awarded to the bidder providing the highest allocation of Profit Oil to the Brazilian Federal Government.

The Pre-Salt Law also provides for a Signature Bonus and Royalty obligations, but clarifies that neither will be recoverable out of the “Cost Oil”. The amount of the Signature Bonus is to be provided for under each bid invitation and Royalties will be charged at 15% of the production value. The customs and tax incentives applicable to the Brazilian oil industry expressly apply to the activities under the new legal framework.

It is worth to highlight that, under the PSC, the joint venture is managed by an operating committee with powers to define exploration and production plans, determine the annual work program to be submitted to the ANP and generally supervise oil and gas operations. Half of the members of the operating committee are appointed by PPSA (including the chairman of the committee) and the other half are appointed by the other contractors. The operating committee’s chairman appointed by PPSA has special veto and voting rights (quality vote).

PPSA was created by Law # 12,304/2010 as a new state-owned company to be engaged in the management of the PSC, oil and gas sales contracts, the representation of the Federal Government on the PSC operating committee, and in any unitization agreement, as well as to be the responsible for assessing the exploration and production plans, ensuring compliance with local content requirements, monitoring project execution, auditing costs and expenses. The company was duly organized and incorporated with the enactment of the Presidential Decree # 8,063/2013.
PPSA is funded primarily from the revenues received by the Brazilian Government under the PSCs plus its share of Signature Bonuses and also management fees under oil and gas sales contracts. PPSA is managed by a Board of Directors and an Executive Board, which shall include representatives from various Governmental ministries, all of them appointed by the Brazilian President, as provided by Article 19 of the company’s articles of organization.

As seen, on November 29, 2016 Law No. 13,365/16 was enacted, cancelling the previous mandatory requirement that PETROBRAS be the sole operator and hold at least a 30% participating interest in all pre-salt fields. The subject law now provides that PETROBRAS shall have a pre-emptive right, and shall determine whether or not it wishes to be the operator of the relevant areas.

Similarly to the concession model, Article 15 of the Pre-Salt Law establishes that, among others, the bid invitations shall provide for the following information:

(a) Description of the blocks being offered, the estimated exploration period, the investments and the minimum exploratory programs;

(b) Respective judgment criteria;

(c) Minimum percentage of Profit Oil to be allocated to the government;

(d) Constitution of the mandatory consortium and PETROBRAS stake at such venture in case PETROBRAS is indicated as the operator based on its pre-emptive right;

(e) Limits, terms, conditions and criteria for calculating and appropriation by the winning bidder of the Cost Oil, as well as for the production volumes and corresponding royalties due;
(f) the criteria for the definition of Profit Oil allocated to the winning bidder; and

(g) the minimum exploration program and the corresponding estimated investments

The bidding process is simpler than the one used under the concession regime, as the main judgment criteria is the share of Profit Oil to be awarded to the Federal Government by the winning bidder.

As opposed to the bidding processes under concession regime, for bidding processes under production sharing regime all bidders must submit the technical, legal and financial qualification documents prior to the bid. The bidding commission will analyse the documentation and only bidders which the qualification is approved will be authorized to submit bids in the public session.

In case of bids under consortium, all consortium members must be qualified individually.

The winning bidder will form a consortium with PPSA, and potentially PETROBRAS, in the cases in which it exercises its right of first refusal to be the operator. Except for PPSA, all other members of the consortium will be jointly and severally liable before the Federal Government, the ANP and third parties.

In addition to acquisition of E&P rights through bid rounds, assignment of E&P rights are also allowed and are actually quite popular in Brazil. Assignment of E&P rights in Brazil requires the ANP’s prior approval. Assignments performed without the Agency’s prior approval shall be null and void.
3.2 Granting Instruments

3.2.1 Concession Agreement

The concession agreement is a bilateral instrument, pursuant to which the granting authority (ANP) awards to the concessionaire, the right to explore for and produce hydrocarbons in a given block, within a defined period of time. The parties’ rights and obligations are defined in the concession agreement and in the regulations issued by the ANP, and its essential clauses are set forth under Article 43 of the Petroleum Law.

The concession agreement is divided into two (2) phases: (i) exploration; and (ii) development and production. The exploration phase may last from three (3) to eight (8) years, whereas the development and production phase may last twenty-seven (27) years (subject to being extended if requested by the concessionaire and agreed by the ANP).

Concessions for the exploration, development and production of petroleum imply the concessionaire’s obligation to explore for hydrocarbons, at its own account and risk, and in the event of success, to produce crude oil or natural gas from the respective block. The ownership of these products will be conferred to the concessionaire, after their extraction and passing through the measurement point, along with all charges relating to the payment of taxes due and the corresponding legal or contractual participations.

The Concession Agreement authorizes the total or partial assignment of acreage within the concession area upon prior ANP authorization. Assignees shall have to meet the technical, economic and legal requirements set by the ANP for a company to become a concession holder in Brazil.

Subject to the provisions of Law # 9,307/1996 (also known as the “Arbitration Law”), disputes arising from the concession agreement shall be settled by arbitration. The arbitration shall be conducted in the city of Rio
de Janeiro, in Portuguese language and based on the applicable Brazilian material law. However, based on the Arbitration Law only disputes involving freely transferable patrimonial rights are subject to arbitration, so for other matters the jurisdiction of the courts of Rio de Janeiro will apply.

During the exploration phase, the concessionaire shall integrally perform the Work Units correspondent to the Minimum Exploratory Program attached to the concession agreement. Concessionaires shall provide the ANP with financial guarantees for the Minimum Work Program, in the form of irrevocable letters of credit, guarantee insurance or an oil pledge agreement. The failure to comply with the Minimum Work Program commitment shall entitle the ANP to enforce such guarantees.

Amongst the variety of obligations under the concession agreement, it is important to highlight the minimum Local Content requirements and the government takes, which will be further addressed below.

### 3.2.2 Production Sharing Contract

The Pre-Salt Law establishes the main requirements for the formation of such agreement, as well as defines mandatory provisions that shall be included in every PSC awarded in Brazil.

As already mentioned, under the current legislation, PETROBRAS has the right of first refusal to be the operator of the pre-salt and strategic areas offered, and a consortium will be formed by the winning bidder, PETROBRAS (whenever it exercised the right of first refusal) and PPSA. Article 29 of the Pre-Salt Law defines the essential provisions of every PSC to be granted in Brazil, including, among other: (i) parameters for definition and calculation of Cost Oil, Profit Oil and royalties; (ii) duration of exploration and production phases, (iii) government takes, (iv) work programs, (v) pricing, (vi) marketing; and (vii) relinquishment obligations. The PSC term will be up to 35 years.
Under the PSC, the company or the consortium that undertakes the activities takes-on the exploratory risks. If it makes a commercial discovery, the contractor has its investments and costs reimbursed in oil (the Cost Oil). Profit is made by deducing royalties and the investments and production costs from the total revenues. Converted into oil, this amount is called Profit Oil, which is then shared between the company (or consortium) and the government, at variable percentages.

Pursuant to the Pre-Salt Law, the Federal Government can enter into PSCs solely with PETROBRAS (100%) or based on tenders in which companies can participate freely.

### 3.3 Permanent Offer of Areas

In order to grant predictability to investment opportunities in the industry, in 2017 the Federal Government has announced a permanent offer of areas, in which selected areas outside the pre-salt polygon that have already been offered in previous bidding rounds but were not awarded, or areas that have been relinquished by the concessionaires, will become permanently available. Companies interested in these areas will have the opportunity to submit proposals.

The dynamics of the permanent offer will be different from the traditional model. A statement of interest from a company, accompanied by a bid bond, will start the bidding schedule for the relevant sectors. Afterwards, the ANP will hold a public bidding session within 90 days of the approval of this guarantee by the Special Bidding Commission ("CEL"). Thus, there will be a bidding process for blocks and marginal fields included in the permanent offer whenever necessary, based on statements of interest from companies.

In the first cycle of the permanent offer of areas ANP is making available 884 blocks in 14 different basins of which 722 blocks are located in the onshore basins of Amazonas, Espírito Santo, Paraná, Parnaíba, Potiguar,
Recôncavo, São Francisco, Sergipe-Alagoas and Tucano and 162 blocks are located in the offshore basins of Campos, Ceará, Pará-Maranhão, Potiguar, Santos and Sergipe-Alagoas.

The enrollment period for the first cycle started on May 2, 2018 and the interested companies may submit the relevant statement of interest, accompanied by the respective bid bond from July 19th, 2018. The offer submission shall occur from November 2018 onwards.

Until the end of December 2018 the ANP is expected to disclose the requirements for participation in a second cycle of the Permanent Offer of Areas in which will be offered 85 onshore exploration blocks from 7 different basins (Amazonas, Paraná, Parecis, Recôncavo, São Francisco, Solimões and Tucano) and 954 offshore exploration blocks from 13 different basins (Barreirinhas, Camamu-Almada, Ceará, Espírito Santo, Foz do Amazonas, Jacuípe, Jequitinhonha, Pará-Maranhão, Pelotas, Pernambuco-Paraíba, Potiguar, Santos and Sergipe-Alagoas).

4. Government Takes

Government take is a group of financial mechanisms through which the Brazilian Government gets compensation for the exploration and production of oil. The government takes detailed in this section will apply depending on the exploration and production regime, as better detailed as follows.

Until December 31, 2017, the reference price used for calculating the government takes was based on the market price of the oil effectively sold by the oil companies in normal market conditions or the minimum price established by the ANP, whichever was higher. However, from January 1, 2018, the reference price used for calculating the government takes is based on the average daily Brent Oil Spot Price.

3 For onshore blocks, the law also provides for what is commonly called the "Owner’s Take", which consists of a payment to the surface owners of the property equivalent, in local currency, to a variable percentage between 0.5% and 1.0% of the petroleum and natural gas production, according to ANP’s criteria.
In 2018, the reference price for each field will be determined by the ANP based on a basket composed of up to four similar types of oil quoted in the international market⁴.

(a) **Signature Bonus.**

The Petroleum Law was the first Brazilian law to foresee the signature bonus (Articles 45 and 46). By legal definition, signature bonus is the amount offered by the bidders during the public bidding processes promoted by the ANP. In the concession regime its minimum amount is established by the bid invitation and it is one of the judgment criteria of the bids, while in the production sharing regime the amount of signature bonus is fixed under the bid invitation. The signature bonus must be paid in Brazilian currency, at once, prior to the execution of the concession agreement resulting from the applicable bidding process.

(b) **Royalties.**

Royalties are a financial compensation that must be paid by the concessionaire, on a monthly basis, in Brazilian currency, as of the date at which the concessionaire starts producing oil and gas in a given field.

For the concession regime, the Petroleum Law establishes the royalty rate from a fixed five percent (5%) to ten percent (10%) of the hydrocarbon production, according to its reference price. The ANP may reduce this royalty rate, in the corresponding bid invitation, down to a minimum of five percent (5%) of the production, taking into account geological risks, production forecasts, and other relevant factors, as per Article 47 of the Petroleum Law and Article 12 of Decree # 2,705/1998.

For the production sharing regime the Pre-Salt law provides for a fixed 15% royalty rate.

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⁴ This change was introduced by Decree No. 9,042/2017 and further regulated by ANP Resolution No. 703/2017.
(c) **Special Participation.**

Special participation is an extraordinary financial compensation due by the concessionaires only in cases of large volume of production or high profitability, payable, on a quarterly basis, in connection with each field of a given concession area. The special participation is applicable only to the concession regime and will be assessed by applying progressive rates varying from ten to forty percent (10% to 40%) over the net revenue of the quarterly production of each field, considering the deductions provided for in the applicable legislation. Such deductions depend on the area of the deposit, the number of years of production, and the respective volume of quarterly production.

(d) **Payment for the Occupation or Retention of the Area.**

The payment for the occupation or retention of the area was created by the Petroleum Law (Article 51) and further regulated by Decree # 2,705/98 and is only applicable to the concession regime. The bid invitation and the concession agreement will provide for the amount payable for the occupation or retention of the concession area, to be assessed at each calendar year, as from the execution date of the concession agreement, falling due by each January 15 of the subsequent years.

(e) **Penalties.**

The concessionaire’s failure to pay any of the government takes described above is subject to the penalties established under ANP Ordinance # 234 of August 12, 2003 (“Ordinance # 234/03”), which may escalate from fifty percent (50%) to one hundred percent (100%) of the total amount of the government takes due.
5. **Procurement of Goods and Services**

5.1 **Procurement by Public and Government-Controlled Entities**

Agreements executed by PETROBRAS for the acquisition of goods and services shall be preceded by a public tender, which is governed by Law 13,303/16 and PETROBRAS bidding and contracts regulations ("Regulamento de Licitações e Contratos da PETROBRAS" - RLCP). The PETROBRAS tender procedure shall follow the general principles that guide the Public Administration, such as isonomy and morality between the participants.

PETROBRAS maintains a supplier’s database which may be used for companies interested in qualifying for taking part in PETROBRAS’ public tenders. For registration purpose, the interested companies must provide PETROBRAS with the legal, technical and financial information and documentation required, pursuant the intended envisioned supplier category.

5.2 **Local Content Policy**

Local content is the commitment undertaken by the E&P concessionaire’s vis-à-vis the ANP for acquiring local goods and services. The chart below depicts the local content percentages undertaken by E&P concessionaires from Brazil Rounds 1 to 13.

5.2.1 **Regulatory Framework**
Local content has always been a major challenge for companies operating in Brazil and, for the concession regime specifically, it has historically been part of the judgement criteria (together with signature bonuses and minimum work obligations) in awarding the bidding rounds. During Concession Bidding Rounds 1 to 4 (from 1999 to 2002), the ANP did not require a minimum local content commitment. The companies bidding for blocks were free to declare a local content goal, which was used as one criteria to award a concession agreement. Thus, in the past, the higher the local content commitment, the better the chances of winning.

Concession Bidding Rounds 5 and 6 (2003 and 2004) introduced a minimum local content commitment for bidders, which varied depending on the location of the block: onshore, shallow or deep water.

At that time, there was no certification method to prove that local content rules were fulfilled, therefore a simple statement from the exploration and production companies to the ANP declaring the domestic origin of the hired suppliers was enough.

However, in 2005, in the context of Bidding Round 7, the local content rules were further regulated and a process was established to measure the local content of goods and services provided under the concession. These general rules, created from Bidding Round 7, were applied to subsequent bidding rounds until Bidding Round 13.

This local content policy was extremely complex, requiring companies to predict, at the moment of the bidding round, detailed percentages of local content to be offered in the exploration phase and development stage, to be applicable to hypothetical discoveries - that could or not occur - and with technical characteristics that could massively vary and influence the use of local infrastructure, goods, suppliers and services. This has generated several fines over past years due to the companies' inability to meet the high percentages committed.
In 2016, the “Program to Stimulate Supply Chain Competitiveness and for the Development and Improvement of Oil and Gas Sector Suppliers” (PEDEFOR) was published. The program aims at encouraging suppliers to invest in productive capacity, technology and innovation in Brazil.

In this context, for Bidding Round 14, the government eased and simplified local content requirements, and local content ceased to be part of the judgment criteria. Also, a global local content percentage has been set for each contract phase, as opposed to the previous regime which provided for both global and per item requirements. The new percentages of local content were applied to Bidding Round 14 (2017) as follows:

Onshore: (i) exploration phase: 50%; (ii) production: 50%

Offshore: (i) exploration phase: 18%; (ii) construction of wells: 25%; (iii) collection and drainage systems: 40%; and (iv) Stationary Production Units: 25%

Also, based on the new rules, the minimum penalty for non-compliance with local content obligations was reduced from 60% to 40% of the non-achieved local content. However, companies will no longer be authorized to request waivers of local content requirements from the ANP in specific situations, which was possible under the previous regulation.

Despite the above, companies continue to be required to evidence local content achievement through reports and certificates, based on the ANP regulation.

Since 3rd Pre-Salt Bid Round held in 2017, the local content commitment applicable to the production sharing regime followed the same model of concession Bid Round 14, including only a global commitment, per phase as indicated above. In addition, in comparison with the 1st Pre-Salt Bid Round, the minimum penalty for non-compliance with local content obligations was also reduced from 60% to 40% of the non-achieved local content and
the contractors are not entitled to request the ANP for waiver of local content obligations.

On April 12, 2018, ANP published the Resolution No. 726/2018 regulating the local content waiver. The waiver of local content commitments in respect to the hiring of particular goods or services can occur in cases of nonexistence of a national supplier, excessive price or terms, or new technology available, and must be submitted for public consultation.

The resolution established the parameters for the occurrence of excessive price, excessive terms and use of new technologies and governs the administrative process for waiver requests. In addition, it regulates the authorization of adjustments of local content percentages, to be granted by the ANP on a discretionary basis and based on public interest, as well as the transfer of surplus local content from one contractual stage to the other.

The new regulation on the waiver mechanism also allowed the possibility of the oil companies to choose between keeping the original local content commitment provided under the original granting instrument or to amend the relevant agreements to provide for the applicability of the new system, introduced in Concession Bid Round 14 for the concession regime, and 3rd Pre-salt Bid Round for the production sharing regime.

However, for companies electing to abide by the new local content rules the following percentages will apply:

Onshore: (i) exploration phase: 50%; (ii) production: 50%

Offshore: (i) exploration phase: 18%; (ii) construction of wells: 25%; (iii) collection and drainage systems: 40%; and (iv) Stationary Production Units: 40% for engineering, 40% for machinery and equipment and 40% for construction, integration and assembling.
5.2.2 Special Custom Regime of Export and Import of Goods Applied to Activities of Researching and Mining of Oil and Gas Fields – REPETRO

In order to develop the oil and gas industry, the Brazilian Government enacted Decree No. 3,161 of September 2, 1999, later revoked, providing for a special customs regime known as “REPETRO.” This regime is intended to provide oil and gas exploration and production companies with access to listed equipment upon a reduced tax burden. It also aims to offer local suppliers favorable conditions vis-à-vis foreign equipment.

According to the Brazilian IRS, the REPETRO regime is currently responsible for 23% of all exemptions of federal taxes in Brazil.

The REPETRO regime is available for equipment above US$ 25,000 in accordance with IRS Normative Ruling No. 1,415/2013 (“REPETRO assets”). In a nutshell, the assets that may qualify for the REPETRO regime are machines, apparels, instruments, tools and equipment used for activities of oil and gas research and production.

In addition, REPETRO also applies to machines, apparels, instruments, tooling, equipment and other parts and pieces intended for: (i) the operation of the equipment listed under the abovementioned Normative Ruling; (ii) rescue, accidents prevention and fire fighting; and (iii) environment protection.

Note that goods subject to finance leasing agreements cannot be imported under the REPETRO regime, according to Article 3, paragraph 4th, - of the IRS Normative Ruling No. 1,415/2013.

Brazilian legal entities may qualify for the REPETRO regime if: (i) they hold the rights to explore and research oil and gas fields (“concessionaires”); or (ii) they were contracted by an oil and gas concessionaire, or its subcontractors, to perform services or to time-charter vessels for the execution of such activities. If the service contractor or the charterer is
domiciled abroad, it can appoint a Brazilian legal entity to act as importer of record for REPETRO purposes.

Brazilian legal entities must obtain a REPETRO license (habilitação) before entering into any REPETRO transaction. This first phase, i.e., the REPETRO license application, consists of a submission of an application by the oil and gas concessionaire before the Brazilian IRS, under which the concessionaire indicates the contractors, subcontractors or third parties designated for the importation of the REPETRO items.

The REPETRO allows the importer to benefit from three different special customs regimes: (i) Drawback; (ii) Notional Export; and (iii) Special Temporary Admission.

- **Drawback** is governed by Ordinance SECEX No. 23, dated as of July 14, 2011, and allows the importer to import inputs with suspension or exemption of federal customs duties (i.e., import duty, federal excise tax, PIS and COFINS) provided that inputs are used in the manufacture of goods destined to exportation.

- **Notional Export** is the sale by the manufacturer or trading companies of goods produced in Brazil to companies domiciled abroad, with payment in convertible currency or national currency. Although the delivery is made in Brazilian territory, it is leveled to regular export for fiscal and exchange purposes, that is to say, exempted from federal taxes (Article 10 of the IRS Normative Ruling No. 1,415/2013).

- **The REPETRO Temporary Admission** allows the importer to import listed equipment valued at U$ 25,000 or above with full suspension of federal customs duties (i.e., import duty, federal excise tax, PIS and COFINS) for their length of stay in the country. REPETRO applicant must provide the Brazilian IRS with, amongst others, the following documents: (i) Request for the Concession of
the Regime (Requerimento de Admissão Temporária or RAT); (ii) Term of Responsibility (Termo de Responsabilidade), through which the applicant undertakes to pay the value corresponding to the taxes suspended if it fails to comply with REPETRO’s conditions; and (iii) instrument of guarantee, if the value of the taxes suspended is more than BRL 100,000.

To qualify for the REPETRO’s temporary admission, a given asset must: (i) belong to a legal entity domiciled abroad; (ii) be imported without exchange coverage; or (iii) come directly from abroad or had been submitted to exportation customs clearance or had been transferred from another special customs regime. In case of vessels, the granting of REPETRO will also be subject to the Brazilian Navy’s authorization to operate in Brazilian waters.

REPETRO’s assets may stay in Brazil, under temporary admission, for the length of the period conceded in the respective Declaratory Act (“Ato Declaratório Executivo - ADE”) which granted the regime request and of the relevant supporting contract (i.e., concession agreement and services agreement executed with the concessionaire or its subcontractor). If the temporary admission was granted under an operational lease, rental or free loan agreement, the regime will be granted for the term of such agreements. The temporary admission of vessels must observe the term granted by the Navy authorities for the vessel’s operation within the country.

In order to extend the validity term of REPETRO, its beneficiary must present to the Brazilian IRS a request for extension of such regime (Requerimento de Prorrogação do Regime or RPR) before it terminates.

The temporary admission regime will be extinguished and the related Term of Responsibility will be cancelled if the beneficiary adopts one of the following measures: (i) re-export the asset abroad; (ii) deliver it to the National Treasury, free of any expenses, if the Customs authority agrees to
receive it; (iii) destruction, at the beneficiary’s sole expense; (iv) transference to another special custom regime; or (v) forwarding for consumption.

In pursuance of an even more attractive scenario to the Oil & Gas industry, REPETRO was updated and had major changes in late 2017. Through the Decree no. 9,128/2017, the Brazilian Government extended the suspension of custom duties until December 31, 2040, previously limited to July 31, 2022.

Along with the long-awaited extension, the Decree also clarified that the REPETRO regime applies to oil and gas assets destined to the development phase, as well as stated that the temporary admission regime can only benefit assets that stay in the country temporarily.

The Decree also determined the suspension of federal custom duties on the definitive importation of assets listed by the Brazilian IRS, as well as the suspension of federal custom duties on the definitive importation of apparels, parts and pieces incorporated to assets imported under temporary admission regime and destined to its operation, or on the importation of tools required for their maintenance, alternatively to the pro-rata admission regime.

The Provisional Measure No. 795/17, later converted into Law No. 13,586/17, also changed the tax treatment granted to the exploration, development and production of oil and natural gas in Brazil.

Law No. 13,586/17 maintained the provisions of Provisional Measure No. 795/17, which:

i. Authorized full deduction, for corporate income tax purposes (Imposto de Renda e da Contribuição Social sobre o Lucro - IRPJ e CSLL) of expenses incurred, at each accrual period, on exploration and production activities, and established the possibility of accelerated exhaustion of assets formed with such expenses;
ii. Altered the limits for the enjoyment of zero Withholding Income Tax (WHT) reduction on amounts paid, credited or remitted abroad, as a result of the charter/rental of vessels, whenever such agreements were entered simultaneously with an agreement for the performance of oil and natural gas exploration and production related services involving related parties;

iii. Established a Special Customs Regime suspending the Import Duty ("Imposto de Importação -II"), the Federal Excise Tax ("Imposto sobre Produtos Industrializados - IPI"), the PIS and the COFINS imposed on the definitive importation of listed assets destined to oil, gas and other hydrocarbons exploration, development and production activities.

The Law also added a few changes not previously determined in the Provisional Measure No. 795/17, such as the prohibition to apply the Special Customs Regime benefits to vessels destined to coastal shipping (cabotage navigation) and inland waterway transport, as well as port support navigation and maritime support navigation, and the previously mentioned extension of the term of validity of the Special Regime to December 31, 2040.

After the changes brought by the Law No. 13,586/17, commented above, the "REPETRO-Sped" regime was created, incorporating the changes and updating the original REPETRO, that will stay in force until December 31, 2020.

The "New Repetro", regulated by the IRS Normative Ruling No. 1,781/17, among other changes, requires that the party paying the charter and/or rental fees under a bareboat or rental agreement be the mandatory importer of the vessel. This means that, unless the holder of the rights to research and explore the oil and gas fields assumes the role of importer of records, the so-called split structure would no longer qualify for the temporary admission regime. Instead, if the Brazilian services contractor
and/or subcontractor imports the vessel, it shall only be able to apply for the temporary admission regime provided that it receives full remuneration in country.

The IRS Normative Ruling No. 1,778/17 was later enacted to clarify the procedures to be adopted by taxpayers regarding the tax treatment to be applied on oil exploration, development and production activities, laying the concepts of exploration and development expenses and determining the duration of the exploration and development phases.

It also establishes a formula for determining the calculation basis to be applied to the determined percentages for the enjoyment of the zero Withholding Income Tax (WHT) reduction on charter/rental of vessels for oil and gas exploration and production activities, as well as for determining the occasional excess portion that will be subject to the incidence of the WHT.

### 5.2.3 Bounded Warehouse Special Customs Regime

IRS Normative Ruling No. 513 of February 17, 2005 and its amendments, allows the operation of the bonded warehouse regime, applicable to the construction and conversion of listed offshore oil rigs and rig modules, inside the rigs under construction or conversion, in quaysides or in any other industrial seashore or port facilities, intended for the construction of maritime structures, oil rigs and rig modules.

The bonded warehouse regime may be applied to materials, parts, pieces and components used for the construction and conversion of listed offshore rigs and modules in Brazil, intended for exploration and production of oil and gas, and contracted by foreign companies. In order to qualify for the regime, a Brazilian company must be contracted by a foreign company for the construction or conversion of an offshore oil rig or module.
This regime provides for the suspension of the federal taxes levied on imports (i.e., import duty, federal excise tax, PIS and COFINS). It also applies to the taxes levied on the local acquisition of goods (i.e., federal excise tax, PIS and COFINS), provided that such goods are incorporated into the oil rig or rig module to be exported.

As a matter of fact, the “suspension” of federal taxes means that no taxes will be due, provided the oil rigs or rig modules under construction or conversion are intended for exportation.

The bonded warehouse regime will also apply to oil rigs and rig modules that are notionally exported from Brazil - i.e., whenever these assets are acquired by a foreign buyer, without leaving the Brazilian territory, and are delivered by order of such foreign buyer to the legal entity contracted to carry out their construction or conversion, the payment shall be made in convertible currency.

On the other hand, if a rig or module is not exported – notionally or physically – the taxes suspended shall be effectively paid with late fine and interest. In addition, if a given asset has not been incorporated into the rig or module being exported, the suspended taxes corresponding to such asset shall also be due.

5.2.4 The State Value-Added Tax (“ICMS”) in the State of Rio de Janeiro

ICMS is a value-added tax on sales and services, payable upon importation of an asset into Brazil, or upon its sale or transfer within Brazil, or as to certain communications and intra and interstate transportation services, at the time when the service is provided.

ICMS rates and tax benefits depend on the type of transaction, and vary from state to state, but are usually levied at a rate of seventeen or eighteen percent (17-18%).
In the State of Rio de Janeiro, the current ICMS applies at a twenty percent (20%) rate on local transactions, as determined by the Article 14, I of State Law No. 2,657/96, and at a eighteen percent rate (18%) on imports of goods.

Law No. 4,506/2002 determined that, in the State of Rio de Janeiro, 2% of the ICMS tax rate must be intended for the State fund for struggle against poverty. The 2018 rates commented above already include this requirement.

5.2.4.1 **Convenio ICMS 130/07**

Under the Brazilian Constitution, ICMS benefits must be created upon the agreement of all Brazilian States and the Federal District through a specific legal act called “Convenio ICMS”. The Convenio ICMS works as a general authorization under which each State (or the Federal District) shall enact its own provisions.

At State level, the REPETRO regime is governed under Convenio ICMS 130/2007, which authorized the States and the Federal District to exempt and reduce the ICMS tax basis on imports, under the REPETRO, of listed assets destined to oil and gas activities.

Among the benefits granted by the Convenio ICMS 130/2007 let us highlight the following:

(a) ICMS tax basis reduction on imports, under REPETRO, of listed assets, as provided by the Sole Annex of the relevant Convenio, applied to installations destined to oil and gas production so that the total ICMS tax burden would be 7.5%, under the noncumulative system, or 3%, under the cumulative system, according to the option performed by the taxpayer. This tax treatment is also granted to imports of inputs, accessories, parts and pieces destined to guarantee the operation of the listed oil and gas assets;
(b) ICMS exemption or tax basis reduction on imports of listed goods so that the total ICMS tax burden would be 1.5% without the accruing of the corresponding ICMS credit;

(c) ICMS exemption for the imports of equipment destined to be used for the provision of services during the exploration phase and to imports of equipment to be used for temporary services in both exploration and production phases, provided that, in the case of the latest, they stay in Brazil for less than 24 months.

(d) ICMS exemption on transactions preceding the exit of assets and goods manufactured in Brazil, destined to entities domiciled abroad, and subsequently followed by the importation of the same assets and goods under REPETRO to be used in oil and gas exploration and production installations, within or outside the State in which the manufacturer is located.

In January 2018, Brazilian States agreed on the Convenio ICMS 03/18, which regulated the States’ concessions of ICMS reductions on importations of goods destined for research, exploration or production of oil and natural gas through the Repetro-Sped regime. The Convenio ICMS 03/18 innovated by conceding ICMS exemption on goods destined for production in the oil and gas industry, which only had the benefit of a ICMS tax basis reduction.

The concession of ICMS exemptions for the production phase by the Convenio ICMS 03/18 pacified the scenario. The exemption of ICMS is now possible not only for the exploration phase, but also for production.

Decree No. 46,233/18 incorporated the Convenio in Rio de Janeiro, maintaining concessions granted on Convenio ICMS 03/18. In order to benefit from such concessions, the company has to explicitly resign from any administrative or judicial discussion over the assessment of ICMS on the import of goods with no transfer of property, as well as operate with the SPED system for bookkeeping.
5.2.5 Contribution for Intervention in the Economic Domain ("CIDE") on Fuels

Law # 10,336/2001 created CIDE which is the contribution levied on the import and sale of certain types of fuel (i.e., gasoline and its chains, diesel and its chains, aviation kerosene, and other types of kerosene, oil fuel, liquefied petroleum gas - including that from natural gas and from naphtha - and ethyl alcohol fuel, as per its Article 3), at the rates fixed in Article 5.

However, Decree # 5,060/2004, and its amendments, including the Decree # 8,395/15, increased the CIDE rates levied on gasoline (and its chains) to BRL100/m³. The relevant decree has also maintained the CIDE rates into zero for other listed products. CIDE taxpayers are the producers, formulators or importers of liquid fuels. Note that the CIDE amounts paid may be deducted from PIS and COFINS levied on the sales of liquid fuels in Brazil.

Note that according to Article 10 of Law # 10,336/2001, CIDE does not apply to sales of goods to commercial export entities (e.g., trading companies), with the sole purpose of exportation.

6. Environmental Liability

Brazilian environmental policy is implemented at federal, state and municipal levels. The Federal Environmental Protection Agency is the Brazilian Institute of the Environment and Renewable Resources (Instituto Brasileiro do Meio Ambiente e dos Recursos Naturais Renováveis – IBAMA). IBAMA is responsible for implementing environmental policy at the federal level, which includes the issuance of certain rules (to specify general rules enacted by the National Council of Environment), the inspections of environmental activities and the conduction of environmental licensing proceedings. States and some Municipalities have their own environmental protection agencies which are competent to enact laws and rules that
must be observed within their respective territories. Environmental licensing may also be conducted by State and Municipal environmental agencies, under the capacity established by Law.

As per Supplementary Law No. 140/2011 and Federal Decree No. 8437/2015, IBAMA is the competent agency to conduct the environmental licensing proceeding for oil&gas activities conducted offshore and in transitional areas, which comprise both offshore and onshore areas and for production of unconventional resources both offshore and onshore (including drilling, fracking, implementation of production lines and flowlines).

The Ruling No. 422/2011, enacted by the Ministry of Environment, regulates and establishes special procedures for environmental licenses for offshore conventional activities. The proceedings vary depending on the type of activity pertaining to the oil & gas industry. The complexity of the proceedings vary depending on the sensitivity of the area, the existence of pre-existing regional environmental studies or studies conducted in previous licensing proceedings or in special reference proceedings conducted directly by IBAMA. The complexity is measured upon the need for more or less detailed environmental studies to be prepared by the applicant during the first phase of each proceeding. As a general rule, the licensing proceedings comprise the following activities and steps:

1. **License for Seismic Research** – a license issued for the conduction of seismic research, which complexity vary depending on the depth of the area in which the research will be conducted or the environmental sensitivity of the area, as defined by IBAMA;

2. **Operating Drilling License** – a license issued for the conduction of drilling activities, which complexity vary depending on the depth of the area in which the wells will be drilled, the length of such area from shore and the environmental sensitivity of the area, as defined by IBAMA;
3. Licensing proceeding comprising the issuance of preliminary, installation and operating Licenses for production and outflow of Oil&Gas – a proceeding concluded with the issuance of the operating license for the production and outflow of hydrocarbons. The first step of the proceeding is generally the most complex and time consuming as it requires the preparation of environmental studies and public hearings, as the case may be. The Preliminary License is granted to attest the viability of the project, while the Installation License authorizes the beginning of the installation of the facilities and the Operating License enables the beginning of the activity; and

4. Licensing proceeding comprising the issuance of preliminary, installation and operating Licenses for conduction of long-term tests – administrative proceeding concluded with the issuance of the operating license required for the conduction of long-term tests, provided that in certain cases, the proceeding may be simplified and only require the issuance of both Installation and Operating Licenses or only the issuance of Operating License, in case the test: (i) involves one single well, (ii) has a duration of less then 180 days, (iii) is located in a length of more then 50 meters from shore, and (iv) is conducted in more then 50 meters depth.

Environmental licenses are always issued based on the premises and information provided during the proceeding and contain conditions to be followed during the validity of the license. In case of breach of the conditions, the licensed company may be subject to administrative penalties and criminal penalties, which may include the cancellation of the environmental license.

As to timing, Brazil has been revisiting its licensing proceedings in an attempt to reduce the timing of the proceeding. Ruling No. 422/2011 provides for terms of 6 or 12 months for IBAMA to issue a final opinion on
the granting or denial of each of the Licenses abovementioned, but such deadlines may be suspended in case IBAMA requires the applicant to present further clarifications on the project or conduct additional studies. In this sense, the length of the proceeding may vary depending on the specific case.

The Ruling also contemplates the possibility of conduction of public hearings during the proceeding, but the need for the hearing will depend on the specific case and/or upon request by the Public Attorney’s Office or other legitimate party, including the relevant stakeholders or the society involved.

Also with respect to environmental licensing proceedings, it is important to mention that except in certain cases, onshore oil & gas exploration and production, as well as activities of midstream and downstream are conducted by the State in which the activity is developed. The environmental licensing proceedings for such activities vary depending on the legislation of each State, but generally comprise three phases, each of them concluded with a Preliminary License, an Installation License and an Operating License. Also in general terms, the first step of the proceeding shall be preceded by the preparation of environmental studies by the applicant and the conduction of public hearings, as the case may be.

The environmental liability includes three ranges of liability: civil liability, administrative liability and criminal liability. The civil environmental liability consists in the obligation of a party causing an environmental damage to recover the environment or indemnify the community for such damage. The environmental legislation also contemplates the piercing of the corporate veil whenever the existence of the legal entity is considered a barrier to the recovery of the damage.

Causing environmental damage, operating without the proper environmental license or in breach of the conditions of the license, among
other legal violations, may also trigger administrative and criminal liabilities.

Law No. 9,605, of February 13, 1998, and Decree No. 6,514, of July 22, 2008, define environmental crimes and administrative infractions, respectively and establish the applicable penalties. Both administrative and criminal sanctions may be imposed over individuals and legal entities that cause environmental damage, including officers, partners, shareholders, members of the board of directors, managers and employees.

Criminal and administrative sanctions imposed over legal entities may vary from warnings to fines that may reach up to R$ 50,000,000.00 (fifty million reais) and the suspension of the activity, the prohibition to obtain public lines of credit or prohibition to contract with Public Authorities. Criminal sanctions over individuals may include imprisonment. It is important to note that the threshold is set per infraction / typified crime. In some recent cases, authorities were able to identify one pollution event in different infractions / crimes, resulting in multiple fines which significantly exceeded the threshold.

In addition to those statutes, there are several other supplementary rules regarding mandatory environmental audits, implementation of environmental impact evaluation, preparation of emergency and contingency plans in case of accidents, restrictions and rules on the use of chemical dispersants, communication of accidents, among others.

It is important to note that a general rule on the environmental licensing is being discussed in the National Congress, aiming at unifying the environmental licensing proceedings and avoid discrepancies among the competent agencies.

[Revised as of July 2018]
Chile Upstream Industry

1. Industry Background

The Chilean Oil & Gas Industry is mainly developed by the State through public companies or through special agreements with private entities. It is a highly regulated market.

Officially founded in June 19, 1950, though Law Nº 9,618. After discovering the first oil well in the country, at Springhill sector in Magallanes, on December 29th 1945, the Chilean Government was determined to create Empresa Nacional del Petróleo (National Oil Company) or ENAP, by its acronym in Spanish, which was officially established on June 19, 1950, with the publication of Law Nº 9,618.

ENAP was created in order to explore, exploit and benefit the deposits of hydrocarbons, whether in Chile or abroad, whether directly or though third parties. Nevertheless, Chile is mainly an importer of Oil & Gas.

From the 90's, Chile has asked Argentina for its natural gas in order to provide gas for industrial process (mainly energy generation) and for residential consumption. Due to the Argentinian crisis during 2001-2004 and since, the Argentinian Government decided to diminish and restrict the natural gas exportation to Chile so the Chilean Government decided to open the market to independent sources of natural gas in order to create competition.

On that scenario, Chile erected its first Liquid Natural Gas reception and regasification terminal (“Gas Terminal”) in Quintero, which is supplied by sea from different sources all around the world since 2009.
The Quintero Gas Terminal is owed by ENAP S.A., Enagas, Metrogas S.A., Endesa S.A. y BG Group; and supply natural gas to central area of Chile.

On April 2010 Suez Energy began the operation of the Mejillones Gas Terminal in order to supply the north part of Chile, mainly associated to energy generation for the mining industry.

The Oil & Gas industry is constantly developing new business opportunities. More recently, in June 2011, ENAP installed an “inland” regasification plant in Pemuco, which supply the local consumption (which is not supplied trough a gas pipeline)

2. Legal Framework

The Chilean Oil & Gas industry is regulated by the following laws:

(i) Chilean Constitution of 1980 which sets out (in Article 19 N ° 24) the State’s absolute, exclusive, inalienable and imprescriptible ownership of hydrocarbon deposits (inc. 6o). The Constitution states that the President of Chile may grant to the State and its companies, or to private companies, through individual Supreme Decrees, exploration and production rights with respect to Oil & Gas deposits. Such rights are granted either through “administrative concessions” or “special (exploration and exploitation) operating contracts” (Contrato Especial de Operación or “CEOPs”).

(ii) Decree D.F.L. N°2 of 1987 consolidating the revised, coordinated and systematized text of the Mining Decree Law 1,089 of 1975. The Decree establishes standard terms for CEOPs, including definitions, contractor guarantees, tax regime, payment terms and importation regime.

(iii) Decree D.F.L. N°1 of 1987 consolidating the revised, coordinated and systematized text of the Law N° 9,618 which created ENAP.
(iv) Law N° 18,410 of the year 1985, which created the Superintendence of Gas.

(v) Decree D.F.L N° 323 of 1931, the Gas Act, which regulates the transport, distribution, concession system and network gas rates, and related State functions.

(vi) Supreme Decree N° 277 of 2007, which establishes the safety regulations for Gas Terminals and other inland facilities.

(vii) Supreme Decree N° 280 of 2009, which establishes the main safety regulations for gas distribution.

The Superintendence of Electricity and Fuels and the Mining Ministry also may, from time to time, include special decrees and norms regarding the commercialization, facilities and prices regarding the Oil & Gas market.

3. **Major Industry Players**

The main player in Chile is ENAP, which was created in the 50’s in order to explore, exploit and benefit the deposits of hydrocarbons, whether in Chile or abroad, whether directly or through third parties.

In the year 2012, Chile, through ENAP produced 127,029 m3 of raw petroleum and imported 9,346,355 m3.

ENAP is 100% State owned and the second largest Chilean state-owned company (after Codelco).

There are other players, mainly distributors of Oil & Gas as Copec, Shell, Petrobras, among others; and gas pipeline operators such as Electrogas, Gas Andes, Gas Atacama, Geoducto Norandino, Gaseoducto del Pacífico, among others.
3.1 Relationship among the Government, NOC and IOCs

Regarding the relationship of national oil companies (“NOC”) and international oil companies (“IOCs”), in Chile there is no difference on the economic treatment. The State is the owner of all hydrocarbons, whether liquid or solid, and grants special licenses through CEOPs to third parties for the exploration, exploration and benefit of hydrocarbons.

ENAP, as the only NOC able to explore and exploit hydrocarbon deposits, acts jointly with NOC and IOCs to perform the investment and works needed.

4. Acquiring E&P Rights

4.1 Licensing Rounds

In Chile, the exploration and exploitation of Oil & Gas is made typically through a CEOP, between the Mining Ministry and the contractor.

A contractor may be a local or foreign entity, and may consist of one or more companies. Under Chilean law, ENAP must carry out exploration and exploitation operations in partnership with a third party by means of a CEOP.

4.2 Granting Instruments

Special Exploration and Exploitation Contracts (CEOPs)

As noted above, CEOP is a contract entered into by and between the State (represented by the Mining Ministry) and a contractor for the exploration, exploitation, or other beneficial use of hydrocarbon deposits, the requirements and conditions of which are determined by a Supreme Decree of the President of Chile pursuant to a constitutional mandate.
The process for granting and execution of CEOPs:

(i) **Process for Granting and Execution of CEOPs**

CEOPs are granted either by tender conducted by the State, or direct negotiation between a prospective contractor and the State. In case of direct negotiations, in order to commence such negotiations, a prospective contractor must submit a proposal to the Ministry of Mining, as described below. In case of a tender, prospective contracts will need to comply with tender procedures and submit the tender documents required by the Ministry.

Upon successful completion of direct negotiations or tender, a prospective contractor will need to obtain the Supreme Decree of the President of Chile, a favorable report from the National Energy Commission, an agreement from the Central Bank Council, and an opinion from the Chilean Internal Revenue Service, as described below.

(1) **Application to the Ministry of Mining**: In order to obtain exploration and exploitation rights, a company must prepare a proposal regarding the contracted area of interest, investment commitments, and periods of exploration and retribution/compensation terms. The Ministry will then begin a consultation process with the company regarding (i) the company’s financial condition; (ii) form of project financing; (iii) payment schedule; (iv) tax system; and (v) other terms. The Ministry will also consult with various state bodies, particularly, the National Boundaries and Limits Authority (Dirección Nacional de Fronteras y Límites del Estado, “DIFROL”) and the Ministry of Defense in order to determine whether the requested contract area is eligible for exploration and exploitation. The factors determining the
retribution/compensation terms basically consist of risks typically inherent in the oil business such as committed investments and the characteristics of the contract area requested for exploration and exploitation. Retribution/compensation may be monetary or in-kind (through sharing of hydrocarbons with the State).

(2) **Tender convened by the Ministry of Mining**: The proposals described above are submitted to the Ministry of Mining as part of the tender process. Tender procedures are determined pursuant to a Ministerial resolution, with timing matters such as deadlines based on local law. Tenders also enumerate the evaluation criteria for prospective contractors.

(3) **Supreme Decree of the President of Chile**: The next step is for the President to issue a Supreme Decree which may set forth the principal terms and conditions of the respective CEOP providing the legal framework to be adjusted by the respective CEOP. The Supreme Decree is published in the Official Gazette and is implemented by the State’s Comptroller General (*Contraloría General*).

(4) **Council Report of the National Energy Commission (Comisión Nacional de Energía or “CNE”)**: The Council of Ministers of the CNE must issue a favorable report prior to the conclusion of the CEOP.

(5) **Agreement of the Central Bank Council**: The Central Bank Council must issue an agreement on exchange rate matters relating to the CEOP upon request by the interested party and prior to the execution of the CEOP. Such agreement is subsequently attached as a schedule to the CEOP.
(6) **Opinion of Internal Tax Authority:** Upon request by the interested party and prior to the execution of the CEOP, the State’s internal tax authority (*Servicio de Impuestos Internos*) will issue an opinion determining how to implement the tax regime provided by the respective Supreme Decree and the CEOP.

(7) **Signing of Contract:** The CEOP is entered into between the contractor and the State (represented by the Ministry of Mining). The CEOP is approved pursuant to a resolution issued by the Ministry of Mining.

(ii) **Phases of the CEOP**

Chile’s current policy is to enter into CEOPs for terms up to 35 years. Generally, CEOPs have the following phases:

(1) **Exploration:** Exploration operations are defined in CEOPs as the activities developed by the contractor for the purpose of determining the existence of Oil & Gas, and the quantity and quality thereof through geological geochemical, geophysical, 2D and 3D seismic and exploratory surveys, among other activities. An exploration phase is subdivided into successive exploration periods. The contract may accede to the next exploration period subject to the fulfillment of minimum work obligations for the prior period specified in the respective CEOP. The investment committed for each exploration period is secured by a bank guarantee letter equivalent to the amount of such investment for the respective exploration period.

(2) **Exploitation:** Exploitation operations are defined as activities carried out by the contractor to develop and
produce the Oil & Gas reserves discovered in the exploration phase. An exploitation phase commences on the date when a commercial discovery is declared with respect to a hydrocarbons deposit. The contractor’s obligations during this phase are determined by a development and production plan setting forth details related to the exploitation operations, which must be approved by the Ministry of Mining.

(iii) **Coordination Committee Overseeing the Performance of the CEOP**

The Coordination Committee is a body responsible for overseeing the performance of CEOPs. Each CEOP has its own Coordination Committee, which consists of an equal number of representatives of each party to the CEOP.

The functions of the Coordination Committee are determined by the respective Supreme Decree and are set forth in the CEOP. The Coordination Committee, inter alia: (a) defines the scope (i.e., shape and size) of exploration areas; (b) approves budgets and work programs; (c) approves the maximum efficient production for each deposit; and (d) requires technical inspections and accounting reports.

(iv) **Grounds for Termination of the CEOP**

CEOPs may be terminated in the following instances: (a) upon a decision by the contractor to terminate any exploration period in accordance with the terms of the CEOP; (b) by a judicial order, upon a breach by the contractor of its obligations under the CEOP; (c) expiration of the term of the CEOP; (d) a *force majeure* event occurring outside of Chile for over three years; or (e) any other grounds specified in the CEOP.
5. **Procurement of Goods and Services**

5.1 **Special Tax Regimes**

The tax regime applicable to the contractor’s oil & gas operations in Chile is governed by CEOPs and relevant Chilean regulations. The most significant of these taxes are currently the following:

(1) First Category Income tax (*Impuesto de Primera Categoría*) currently at a rate of 18.5% for commercial year 2012, calculated on an annual basis on corporate net profits;

(2) Withholding tax of 35% on dividends or profits paid to non-resident shareholders or quota-holders, against which is creditable the First Category tax effectively paid on such dividends or profits;

(3) Value Added Tax ("VAT") with a rate of 19% on domestic sales of goods and provision of certain services. VAT paid on the account of domestic purchases can be reimbursed to the contractor if the contractor has no sales in Chile. The VAT reimbursement must be requested from the applicable tax authorities within two months of payment of VAT by the contractor; and

(4) Withholding tax on service fees paid to foreign beneficiaries, at a general rate of 35%. However, if the services performed qualify as “technical” or “professional”, the applicable withholding tax rate is

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1 Please note that according to law No. 20.455 of 2010, the First Category tax was increased to 20% for commercial year 2011, decreased to 18.5% for year 2012 to finally return to its ordinary 17% rate as from commercial year 2013. Nevertheless, the Government has announced a tax reform -currently being discussed before the Chilean Congress- which includes a permanent increase of the First Category tax to a 20% rate, as from commercial year 2012.
15% - or 20% if between related parties or if the beneficiary resides in a tax-heaven territory—².

Current Regional Tax Incentives

The XII Region of Magallanes of Chile has different tax, customs, labor and other benefits aimed to promote development of such region.

5.1.1 **Navarino Law Number 18,392, as amended.**

Since 1985 and for the following 50 years, Law 18,392 created a preferential tax and customs treatment for certain entities established in the preferential zone of the XII Region of Magallanes and exclusively performing industrial, transport, tourism and mining or ocean exploitation activities and established within preferential zone limits.

Hydrocarbon extractive activities and those related to processing such substances are expressly excluded from the preferential treatment—³.

The entity must obtain an authorization from the Regional Government Authority ("Intendente Regional"), which will indicate the location/address of the entity. Such authorization will be incorporated under a public deed and signed by the Regional Treasury on behalf of the State of Chile and the representative of the entity. This public deed will be considered for all legal purposes as an agreement (contract/law) between the State of Chile and the entity, which shall incorporate expressly all the rights, benefits, exemptions under Law 18,392.

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² Please note that Double Tax Treaties -when applicable- may reduce or eliminate applicable rates.

³ To this effect, industrial entities are deemed to be those that develop their activities in a factory or plant (i) elaborating, preserving and/or transforming natural substances or already elaborated, and (ii) performing those industrial services necessary to perform industrial processes. Such entities must use at least a 25% of employees and supplies from the preferential zone.
Benefits are lost if activities are not initiated within a 2 year term since granted, or if activities are suspended during 1 year or more at any time.

5.2 **Tax Benefits Under Navarino Law.**

(a) Corporate Tax Exemption.

(b) Customs Duties Exemptions. Duty Free Area. The import of assets is exempt from customs duties, currently at a 6% rate assessed on the transactional value or CIF as the case may be\(^4\). Imports are also exempt from Value Added Tax (VAT), currently at a 19% rate. Both taxes under the normal customs regime are payable on Customs clearance. The exemption also applies to all other charges and fees -e.g. dispatching fees- charged by Chilean Customs.

These exemptions apply to the import of foreign assets necessary for the developing of activities e.g. primary assets, partially elaborated assets, parts or pieces, machinery, equipment, etc. Certain assets are excluded (e.g. guns and vessels).

(c) VAT Exemption. Sale of assets imported from the Punta Arenas Duty Free Zone to the entities are exempt from VAT. In addition, the sale of Chilean assets (from the rest of the country) to the entities and that are necessary to perform its activities and brought into the preferential zone are considered as an export for VAT purposes and thus are also VAT exempted. Also, sales and services rendered by individuals or entities domiciled or resident in the preferential zone to individuals or entities residents in the same zone, in respect to assets located and/or used or activities rendered in the zone are also VAT exempted.

\(^4\) Please note that according to the language of the upcoming tax reform - currently being discussed before the Chilean Congress - the custom duties will be gradually reduced to 0% until the year 2015.
Sale or services rendered by the entities to the rest of the country are subject to ordinary 19% VAT.

(d) 20% Reimbursement by Treasury. Chilean Treasury will reimburse a 20% of the sales (VAT excluded) to the rest of the country or for services rendered from the preferential zone to the rest of Chile, excluding the extension zone of the Punta Arenas Duty Free Zone.

(e) Real Estate Tax Exemption. Real Estate or immovable property located in the preferential zone is/are exempt of Real Estate Tax.

5.2.1 Benefits for the Areas of Porvenir and Primavera of the XII Region of Magallanes contained in Law 19.149 of June 1992.

This Law grants similar benefits to those contained in Law 18,392 but exclusively refers to such 2 areas –Porvenir and Primavera– of the XII Region of Magallanes.

5.2.2 Tax and Customs Benefits of Decree Law 1,089 of 1975 re Special Operation Agreements for the Exploration and Exploitation or Benefit of Hydrocarbons.

The Tax and Customs Benefits Decree Law 1,089 of 1975 regarding CEOPs, refunded in DFL N°2 of 1987 (“Decree Law 1,089”) provides a special exception tax regime for CEOPs that applies in lieu of the general tax regime. In addition to the Decree Law 1,089, the tax regime under each CEOP is also subject to a Presidential Decree and a public deed containing the CEOP, the terms of which describe the tax treatment granted to the respective CEOP. Furthermore, CEOPs usually include a specific Revenue Ruling issued by the Chilean tax authority.

Decree Law 1,089 sets forth the regulations pursuant to which the State authorizes private companies to explore and exploit Oil & Gas reserves within its borders. It also sets forth special applicable tax treatments and/or benefits aimed at providing incentives for such activities. Such tax
incentives are granted to (i) contractors which are incorporated in Chile and which have entered into a CEOP; and (ii) subcontractors not incorporated or resident in Chile.

Such tax special treatment addresses not only compensation paid pursuant to a CEOP or a sub-contract but also other fiscal terms such as special VAT benefits and special customs regimes applicable to the importation of property or equipment into Chile for operations pursuant to the CEOP. For instance, Decree Law 1,089 affords the applicability of a special customs regime towards the importation into Chile of property and equipment required under a CEOP. Furthermore, Article 8 of Decree Law 1,089 renders in-kind (i.e., hydrocarbon) payments to contactors under CEOPs exempt from all taxes. Additionally, all contracts and documents (including the CEOP itself) evidencing such payment are exempt from any applicable stamp taxes.

With regards to compensation paid to contractors under the CEOP, Article 5 of Decree Law 1,089 provides two alternative tax treatments from which the President of Chile may choose, and which treatment is then set forth in a Supreme Decree. These two treatments are considered to be more favorable to the contractor than the standard Chilean income tax regime and are described below:

1. **Treatment 1.** No other direct or indirect tax other than a 50% tax will affect the compensation paid under the CEOP. This special tax regime applies to gross amounts paid to the company as compensation under the CEOP. No tax deductions are allowed under this regime. The President may lower this tax below the 50% rate, but such lower tax is rarely granted.

2. **Treatment 2.** The private party to the CEOP may be subject to standard income taxation pursuant to Chilean income tax law in effect at the time of execution of the CEOP. This treatment provides for tax stabilization in regard to the income tax laws in
effect at the time of execution of the CEOP, as the party will be locked into the income tax rate in effect as the time of execution of the CEOP. It is, however, uncertain if this tax treatment enables the stabilization of any tax reduction or special treatment contained in any applicable tax treaties in force in Chile at the time the CEOP is executed.

This regime is beneficial not only because it is exempt from any adverse future changes in the income tax law but also because the standard income taxation would allow the taxpayer to deduct expenses (e.g., exploration costs under the CEOP) or apply depreciation towards fixed assets. Further it enables the recognition or carrying forward of existing net operating losses.

Article 9 of Decree Law 1,089 provides a tax treatment to subcontractors not incorporated or not resident in Chile. Such entities are only subject to a 20% withholding tax on their income. This tax treatment prevails over any other tax treatment under Chilean law.

Article 5 of Decree Law 1,089 allows contractors to use the “exporter VAT recovery procedure.” This procedure is contained in Article 36 of the VAT Law and in general allows exporters to recover VAT paid on purchases of goods and services for export activities. This is an economically relevant benefit given that the current applicable VAT rate is 19%.

6. Environmental Liability

The Chilean environment law N°19.300 indicates that the holder of any project or activity covered by Article 10 of the law (including projects involving Oil & Gas assets) must submit an Environmental Impact Statement or develop an Environmental Impact Study as appropriate.

According to Article 10 of the Environmental General Basis Law projects designed to carry out the following activities must first be evaluated and
assessed. These projects undergo environmental impact assessment at all stages, namely, design, construction, operation and closure.

- Aqueducts and other water-carrying infrastructure.
- Electricity transmission lines.
- Electricity generation plants with more than 3 MW of installed power.
- Nuclear reactors and associated installations.
- Airports, road terminals, highways and public roads.
- Harbours, shipyards and maritime terminals.
- Land and tourist development projects not covered by urban planning regulations.
- Some urban regulations.
- Mining projects.
- Gas and oil pipelines.
- Industrial manufacturing projects.
- Agriculture and cattle projects.
- Fishing and aquaculture projects.
- Hazardous substances production, transport, storage, disposal and recycling.
- Liquid waste treatment and disposal projects.
- National parks and natural reservations projects.
Mass chemical distribution over populated sectors.

The developer of a proposed project must produce an Environmental Impact Study (EIS) or an Environmental Impact Declaration (EID). According to the criteria established by the Environmental General Basis Law, projects which have a bigger environmental impact need to present an EIS which is a larger, more detailed and more expensive document than a simple EID. If a project has the effects, characteristics or circumstances described in article 11 of the law, then the project must therefore be submitted to the Environmental Agency through an EIS.

When deciding whether an EIS is necessary the Environmental Agency will consider the following issues:

(a) Risks to public health due to the amount and type of emissions or waste to be generated by the project.

(b) Adverse effects on the levels and quality of natural resources in the surrounding area.

(c) Human displacement or a significant change in the way of life of local communities within the area of the project.

(d) Proximity to communities, natural resources or protected areas.

(e) Change to the landscape and tourist value of the place where the project will be located.

(f) Change to sites of archaeological, anthropological or historical interest.
Regarding (c) and (f), most archaeological sites are located in northern Chile, and most settlements of indigenous people are located in the south, in the Ninth Region. Indigenous groups and NGOs representing the interests of indigenous people have a very strong presence and active role in Chilean public life.

[Revised as of August 2018]
Colombia

Colombia Upstream Industry

1. Industry Background

Since the Constitution of 1886, Colombia declared the State-ownership of the subsoil, including all minerals. Starting in 1905, Colombia has administered its oil and gas reserves through public concession agreements granted by the government that implied the payment of a royalty.

By the mid-twentieth century, oil production was obtained from the commercial exploitation of properties given in concession. The most significant concessions in terms of production were those of De Mares, Barco and Yondó, which together represented over 90% of crude oil production.

Prior to the reversion of the De Mares Concession technical reports were showing a decline in production which made several international companies move their investments to other oil countries. This scenario imposed the need for a new strategy to encourage foreign investment in exploration and exploitation activities, materialized with the issuance of a new oil law in 1961 and was finally completed by Law 20 of 1969.

These new laws permitted Ecopetrol as manager of the subsoil since 1969 to partner with private (foreign or national) companies in order to develop exploration and exploitation activities. The agreements were basically risk contracts, in which the partner assumed all the exploration costs until a discovery was made, when Ecopetrol started to share 50% of the development investments and costs and received 50% of production after royalties. The royalties would be not less than 16%.

In 1974, the exploration and exploitation scheme in changed with the issuance of Legislative Decree 2310, whereby the concession regimen was
abolished and which established that the exploration of hydrocarbons of national property would be carried out exclusively by Ecopetrol, directly or through partnership contracts, services operation contracts, or other type of contract different than concession agreements. These were known as “association contracts” whereby all the exploration activities were born by the private partner on its own account and risk, over a period not exceeding six years and remained free to withdraw from the designated area at any time without penalty, provided they fulfilled their annual exploration commitments. Once a discovery was made in the opinion of Ecopetrol, it reimbursed in oil half the cost of the exploration wells that entered production and it received 50% of the product after royalties, which were set at the 20%.

This was the regime that operated for nearly thirty years, until a significant reform took place in 2003 that dramatically changed the Colombian upstream industry. By means of Decree 1760 of 2003 the management and control of the Colombian hydrocarbons resources were transferred from the state-owned company Ecopetrol to an independent governmental agency created for such purpose, the National Agency of Hydrocarbons (“ANH”).

Up until then, Ecopetrol concentrated both roles (i) the administration and control of the hydrocarbons resources of Colombia and (ii) the typical exploration and exploitation activities of a commercial oil company.

With this reform Ecopetrol was restructured as a public stock company and the ANH was created as administrator and regulator of the hydrocarbons resources of the nation.

As of January 1st, 2004 one of the main purposes of the ANH is the competence to enter into the new exploration and exploitation contracts (“E&P Contracts”), subject to the terms and conditions set forth by the agency as regulator. These contracts are awarded as the result of public bids known as “Colombian Rounds”, as explained below.
2. Market Update

On May 19, 2017, the Colombian National Hydrocarbons Agency (“ANH") enacted Agreement No. 02 of 2017 (the “New Regulation”), which repealed and superseded the former regulation (Agreement No. 004 of 2012) governing the allocation of rights to explore and exploit hydrocarbons through the award of E&P contracts, and the rules governing performance of the same contracts.

The New Regulation sets forth several novel provisions aimed at promoting hydrocarbons exploration and production activities given the current crude prices environment.

Prior to this, the last Colombia Open Round, which took place in 2014, resulted on offers made on 26 of the 90 blocks available. The Colombia Open Round 2014 offered 19 blocks for exploration of unconventional resources (shale oil and shale gas) to those parties that meet the capacities to bid and enter into exploration and production contracts for unconventional resources.

Under the New Regulation, new competitive processes for the granting of rights to explore and exploit hydrocarbon resources will be launched, but initiative on the specific areas to be awarded will come from investors, rather than the government (ANH).

The New Regulation contains a new system for the classification of areas, which is based on the technical information available on them. Areas can be classified as (i) Mature or Explored; (ii) Emergent or Semi-Explored; or (iii) Immature, based on certain exploratory risk level indicators related to: the level of knowledge of the oilfield system; the distance to the nearest productive field; the number of wells drilled for each 10,000 hectares; the kilometers of 2D seismic for each 10,000 hectares; and the percentage of the area covered with 3D seismic.
The New Regulation also contains a certain chart that sets forth specific scores to be granted to participants applying for the allocation of a certain area, depending on the basin where the area is located (i.e., Putumayo, Cesar, Llanos, Guajira, Valle Medio del Magdalena, etc.).

Furthermore, ANH will create, publish, maintain updated and set the rules governing a registry of companies interested in participating in competitive processes to be conducted over available areas. While details of this registry are yet to be defined (ANH expects for this to happen before the end of 2017), the nature of this registry, which is compulsory for companies that intend to apply for the award of E&P contracts, is that of a pre-qualification or pre-habilitation.

Based on the information recorded by each interested company in this registry, ANH will determine the characteristics of the areas to which an interested company may apply (in terms of number, nature, category and prospectivity).

This registry is to be renewed annually, and updated whenever any information on the relevant company changes.

3. Legal Framework

Since 1886, hydrocarbons, under the general category of minerals, have been reserved as property of the Nation. The Colombian Constitution establishes that as a general rule, the Colombian Nation is the owner of subsurface and the natural non-renewable resources of the territory (article 101 and 102).

The basic statute that regulates the Oil and Gas industry is the Petroleum Code (Decree 1056 of 1953). This Code establishes that contracts for exploration and exploitation of hydrocarbons are governed by Colombian law and are subject to the jurisdiction of Colombian courts. Foreign companies who want to enter into oil contracts and undertake exploration...
and exploitation activities, must establish a Colombian branch, complying with the formalities of the Colombian Commercial Code. The Colombian branch must be domiciled in Bogota.

Additionally, the petroleum industry and its activities of exploration, exploitation, refinement, transportation and distribution are declared as public utility.

Resolution 181495 of 2009 from the Ministry of Mines and Energy ("MME") regulates specifically the technical aspects of exploration and exploitation activities in Colombia. Exploration is defined in the aforementioned resolution as the studies, works and programs developed in order to determine the existence and location of hydrocarbons in the subsurface.

To start exploitation activities, the contractor must first submit the design of production facilities and obtain approval from the MME. Once the facilities are installed they will be checked to verify if they correspond to the approved design, otherwise the authorization to start the corresponding exploitation will not be granted.

In addition, the contractor must provide an analysis of operational risk, environmental global license and copies of permits or approvals, without prejudice to other documents or information as required.

4. **Major Industry Players**

The creation of Ecopetrol was authorized by means of Law 165 of December 27, 1948 which finally led to the establishment of the company, on August 25, 1951 as a state-owned company in order to receive the reversion of the De Mares Concession. Ecopetrol started its activities in the hydrocarbon sector as a state-owned industrial and commercial company in charge of administering the nations hydrocarbon resources, and began to grow as other concessions reverted and became part of its operation.
As indicated before, Ecopetrol’s situation changed after 2003, with the organization of Ecopetrol as a public stock company one hundred percent state-owned, eliminating the administration role and devoting the company to commercial activities in competitive terms with the other oil companies in the upstream sector, with greater administrative, budgetary and labour autonomy.

Later, in 2007, Law 1118 of 2006 authorized the capitalization of Ecopetrol by means of an issuance of shares of up to 20% of its ownership, in which Colombian citizens and the so-called solidarity sector could participate. The democratization of shares took place in mid 2007 of 10.1% of its capital share acquired by private investors. This capitalization meant another significant change in its shareholding nature, and also in the way of conducting business, funding its operations, entering new lines of business and increasing acquisition plans. Ecopetrol became a business oriented company, with a legal framework closer to private law.

Ecopetrol is current trading in the Colombian, New York, Lima and Toronto Stock Exchange with international presence. Today is the largest oil company of the country with a strong presence in the exploration and exploitation activities focused on petroleum, gas, petrochemicals and alternative fuels.

4.1 **Relationship among the government, NOC and IOCs**

In Colombia after the 2003 reform, by means of which the NOC became another economic agent which competes with IOC’s in equal terms in the licensing rounds that the ANH undertakes to allocate areas for exploration and exploitation purposes. Nevertheless, Ecopetrol still have some areas that can be managed and operated directly or through contracts with private parties (those blocks that are part of its patrimony as a consequence of the 2003 spin-off and separation of roles reform). Other than that, the ANH is the sole governmental agency competent for
granting new rights for exploration and exploitation of Colombian hydrocarbons to oil companies, including Ecopetrol.

Thus, after the 2003 reform that opened the upstream sector in Colombia our NOC does not have any privileges in the licensing rounds of the ANH.

5. Acquiring E&P Rights

Colombia has managed its national hydrocarbons resources through different types of contracts: (i) until 1974 through concession agreements, (ii) from 1974 until 2004 through association contracts with Ecopetrol and (iv) as of January 1st, 2004 by means the new exploration and exploitation contracts (E&P contracts), which are the current legal framework for the allocation of E&P rights by the ANH.

5.1 Competitive Processes

The terms of the allocation of areas for exploration and exploitation of conventional hydrocarbons through E&P Contracts are regulated by means of the Agreement 02 of 2017\(^1\) of the ANH that derogates Agreement 004 of 2012.

This regulation establishes the different modalities to award an area and to enter into E&P Contracts in Colombia:

- Open competitive process: The ANH will initiate the negotiating process with the bidder that has an acceptable contracting proposal. This is the most common methodology for the award of areas.

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\(^1\) The ANH has issued a different set of rules for the award of unconventional hydrocarbons as explained below.
• Closed competitive process: The ANH will invite a predetermined group of companies to submit a proposal. The ANH will initiate the negotiating process with the bidder that has an acceptable contracting proposal.

• Direct assignment: Previous authorization of the Board of Directors of the ANH, the ANH will assign exceptionally areas that have been specially selected. Further regulation on the process for this methodology to be applied is pending to be issued.

Notwithstanding the above mentioned possibility, the ANH is not currently undertaking any direct assignments for E&P Contracts.

In any process of assignment the ANH will study and evaluate the legal, financial, technical, operational, environmental, corporate social responsibility capacity of the bidder.

• Legal capacity: The ANH will review the existence of the company and its controller if applicable. National and foreign companies can participate as well as Consortiums and joint ventures. The ANH requires that the companies have in their social purpose the exploration and exploitation activities for at least five years prior to the submittal of documents.

• Financial capacity: the contractor must prove that it has the financial capacity to comply in a timely and correct manner with all the obligations of the E&P contract.

• Technical and operational capacity: the ANH will review that it has the minimum operational capacities (in terms of levels of production and reserves volumes) required to conduct the obligations set forth in the E&P contract, as well as the equipment and team work of the contractor.
Interested companies who intend to become part of the registry mentioned above may exceptionally accredit their capacity requirements (financial, technical, operational and environmental) by presenting information of their home office, a subsidiary controlled by their home office, or even an affiliate forming part of the same corporate group.

Competitive processes for the award of E&P (and other oil and gas) contracts will be based on a first-come, first-serve basis. Thus, the first entity that files a proposal for a specific area will have a right to upgrade any further proposals filed by subsequent participants, in order to be preferred for the award of the contract, so long as the conditions offered are more beneficial than those presented by its competitors.

**Judgment Criteria**

The judgment criteria are determine in each round. Nonetheless, Agreement 2 of 2017, establishes general factors that will be taken into account for the qualification of the proponents:

1. The proposed additional exploratory program and the investment to develop it, above the minimum required
2. Participation offered in the production
3. Other economical benefits
4. Any other kind of remuneration

**5.2 Granting Instruments**

The E&P Contract to be granted by the ANH has the following main characteristics:

(i) Parties: The ANH and the Contractor selected according to any of the processes established in Section 4.1
(ii) Term:

- Exploration: Six (6) years as of effective date, divided into sub-phases of different duration.
- Exploitation: Twenty-four (24) years as of declaration of commerciality.

(iii) Minimum work program commitment:

The minimum work program corresponds to the activities of exploration that the contractor will execute during the term of the contract and that do not correspond to the activities that the contractor offer to undertake in the additional investment plan.

(iv) Fiscal regime (i.e., government takes)

(a) Royalties

As part of the country’s movement towards attracting foreign investment in the oil and gas sector, a flat rate of 20% in the Association Contracts was replaced by a sliding scale set forth in the law that ranges from eight percent (for production of up to 5,000 boe/d) up to a maximum of 25% (for production exceeding 600,000 boe/d). Additionally, the sliding scale rate is applied on a per field basis.
The sliding scale royalty rates are as follows:

<table>
<thead>
<tr>
<th>Field Production (bbl/d)</th>
<th>Royalty Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 – 5,000</td>
<td>8%</td>
</tr>
<tr>
<td>5,001 – 125,000acx</td>
<td>8% – 20%</td>
</tr>
<tr>
<td>125,001 – 400,000</td>
<td>20%</td>
</tr>
<tr>
<td>400,001 – 600,000 plus</td>
<td>20% – 25%</td>
</tr>
</tbody>
</table>

Of the royalties applicable for light crude oil, there are discounts applicable for certain products as explained:

- Natural gas has a 20% discount
- Heavy oil (<=15° API), has a 25%; and
- Natural gas offshore, 40%.

Once a property has produced more than five million barrels of oil (before royalties), a “windfall profit tax” or “high prices rights” clause may be applied. If the sales price is in excess of a certain threshold price, a percentage is applied to the excess. The threshold price and the percentage applied to the excess varies among contracts as explained below.

(b) Fees for Use of the Subsoil

Periodic cash payment to be made by Contractors, as compensation for the exclusive right to use the subsoil of the allocated area for evaluation, exploration and production of the Type of Deposit subject to the corresponding Contract, the amounts and timing of which payments are to be stipulated in the respective contract, in accordance with the law.
In Exploration Areas, this corresponds to a fee per surface unit, denominated in dollars of the United States of America.

In Evaluation and Production Areas, to a fee per production unit belonging to the Contractor, also denominated in dollars of the United States of America.

The chart below summarizes the fees per surface unit:

<table>
<thead>
<tr>
<th>size of area</th>
<th>First 100,000 Ha</th>
<th>Additional Ha</th>
</tr>
</thead>
<tbody>
<tr>
<td>Phase Duration</td>
<td>&lt; 18 months</td>
<td>&gt;18 months</td>
</tr>
<tr>
<td>Onshore Areas</td>
<td>2.63</td>
<td>3.50</td>
</tr>
<tr>
<td>Offshore Areas</td>
<td></td>
<td>0.88</td>
</tr>
</tbody>
</table>

(c) Fees on account of “high prices”

For exploration of onshore conventional hydrocarbons contracts it consists of a percentage payable to ANH between 30% and 50% which is applied to the excess price of hydrocarbons with respect to international markers (WTI for crude oil and US Gulf Coast Henry Hub for gas in case of export, or a marker agreed between the parties for domestic consumption).

(d) Economic right as Share of production

The contractor shall pay the ANH a share in the production after royalties as a economic right.

It corresponds to the share of net production (after deducting royalties) equal or higher than one (1), that the Contractor shall pay to the ANH as compensation for the signature of the contract
in cash or in kind, represented in barrels equivalent of oil (BOE). This production is not taken into account for the basis of calculating royalties or High Prices Right.

(e) Share of production during the extension of the Exploitation period:

The Contractor shall pay the ANH at least 10% of the liquid hydrocarbon production, 5% of non-conventional hydrocarbons, or 5% of non-associated natural gas or heavy or extra heavy liquid hydrocarbons, as of the date of the expiration of the initial duration of the Exploitation period, calculated after deducting royalties and the economic right as share of production.

(f) Transfer of technology

The contractor commits to develop scientific and technological activities which purposes and conditions will be determined by the ANH.

The contractor assumes 100% of the costs of such activities. In no event this obligation can exceed the amount of USD 124,920 in 2013 for phase or for a calendar year, as applicable.

(v) Title to oil

The Contractor has the exclusive right to undertake and develop exploratory activities in the assigned area and to produce the hydrocarbons that are property of the Government, that are discovered in such area, on its behalf and at its own risk.

(vi) Assignment (farm-out)

The contractor has the right to assign it rights, interests and obligations under the E&P Contract, with the prior written authorization by the ANH, to another company, consortium or
joint venture that has the capacities required by the ANH. In any process of assignment the ANH will study and evaluate the legal, financial, technical, operational, environmental, corporate social responsibility capacity of the proposed assignee.

(a) Process:

1. The Contractor must submit written request for the assignment to the ANH indicating the main points of the negotiation (i.e., name of the assignee, capacity, value of the assignment etc)

2. The ANH will have a term of 60 business days, once it has receive all the complete information, to approve or not the assignment.

(vii) Local content requirements

The contractor shall favor local, regional or national suppliers of goods and services in equal competitive terms of quality, opportunity and price with others. Within the executive report that must be submitted every six months, the contractor has to provide information regarding contracts entered with local, regional or national suppliers.

(viii) Relinquishment and abandonment

(a) Abandonment Fund

The Contractor must establish a fund to guarantee the financing of the necessary activities to execute the abandonment program of the wells and the environmental restitution of the assigned areas for the production at the end of the exploitation period.

The amount of the Fund will be calculated depending on estimated cost of abandonment, production and reserves.
(b) Relinquishment

After the first 18 months of execution of Phase 1 of the exploration period whether in prospective areas for conventional deposit or in non conventional ones, and during any following phases of the posterior exploration period, the Contractor is entitled to relinquish the E&P Contract, provided it has satisfactorily fulfilled the exploratory program, and all the applicable obligations and investments, both minimum and additional, corresponding to the Phase then in progress. To this end, it shall give written notice to the ANH before the expiration of the term of the respective Phase.

In case the Contractor relinquishes during Phase 1, after the first 18 months have passed, the Contractor will have to pay to the ANH, within the following 5 days of its decision, the amount of the investments not yet made of the exploration program both minimum and additional in the case of E&P Contracts, or the total term of performance, in the case of Technical Evaluation Agreements –TEA–.

(ix) Unitization

When an economical exploitable area extends outside the contracted area, the contractor, in agreement with the ANH and other interested parties, must put in place, prior approval from the competent authority, a unified cooperative exploitation plan, according to the current Colombian regulations.

According to article 31 of the Petroleum Colombian Code (Decree 1056 of 1953), when an oil structure is located on two (2) or more land for different contractors, and this circumstance gives rise to conflicts between them, such subjects must, if so provided by the government, implement a cooperative exploitation plan, in
accordance with the technique and that will be regulated by the government. The provisions of this article are mandatory not only for contractors working in areas of national ownership, but for the operators on privately owned land.

(x) Dispute resolution method.

(a) Executive instance

Any difference or controversy arising from or in connection with the contract will be resolved by the authorized officers of each party.

If the parties cannot resolve the issue within the following 30 days of the notification of the controversy, the matter will be submitted to the highest executive, residing in Colombia, of each party, in order to seek a joint solution.

In that instance the parties may agree that the controversy will be resolved by technical experts if this is the nature of the controversy. If the parties cannot agree in the appointment of the technical experts they can submit that decision to a third party that will in charge of making this appointment.

If the parties reach to a solution, they will have to sign an agreement indicating the decision within the following 30 days of the submission of the conflict to the executives previously mentioned.

(b) Arbitration

If the parties cannot resolve the issue within the following 30 days of the submission of the conflict to the executives previously mentioned, or if the parties do not sign the agreement within the following 15 days after the expiration of the 30 days term, the
parties can agree on alternative mechanisms of resolution of conflict permitted by Colombian Law.

The controversy or difference will be solved by an Arbitration Tribunal installed before the Arbitration and Settlement Center of the Chamber of Commerce of Bogota, which shall be ruled according to its statutes and regulations. The tribunal shall have three (3) arbitrators appointed by mutual consent among the parties. If the parties do not consent on the designation of the arbitrators, then these will be appointed by the Arbitration and Settlement Center of the Chamber of Commerce of Bogota, by request of any party.

The arbitral award shall be issued in accordance with the law, and in accordance with Colombian laws.

The tribunal will be installed in the facilities of the Arbitration and Settlement Center of the Chamber of Commerce of Bogota

6. **Government Takes**

There are two types of Government Takes, one in favor of the National Treasury (royalties) and the others in favor of the ANH (High Prices right, economic right as Share of production, surface fee and Transfer of technology).

<table>
<thead>
<tr>
<th>Government Take</th>
<th>Rate</th>
<th>Payment Base</th>
</tr>
</thead>
<tbody>
<tr>
<td>Royalties</td>
<td>From 8 to 25% (subject to discounts as indicated above)</td>
<td>gross production</td>
</tr>
<tr>
<td>Share of Production</td>
<td>equal or higher than one (1)</td>
<td>share of net production after deducting royalties</td>
</tr>
</tbody>
</table>
### Government Take

<table>
<thead>
<tr>
<th>Government Take</th>
<th>Rate</th>
<th>Payment Base</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fee to the Owner of the Land</td>
<td>From 1 to 7% of the gross production</td>
<td>The percentage will depend on the distance from the pick up center and the port of embarkation</td>
</tr>
<tr>
<td>Fee for high prices</td>
<td>between 30% and 50%</td>
<td>The excess price of hydrocarbons with respect to international markers</td>
</tr>
<tr>
<td>Transfer of technology</td>
<td>to be determined by the ANH</td>
<td>In no event this obligation can exceed the amount of USD124,920 in 2013 for phase or for a calendar year, as applicable</td>
</tr>
</tbody>
</table>

### 7. Procurement of Goods and Services

#### 7.1 Procurement by Public and Government-Controlled entities

As mentioned previously, in Colombia, the most common procedure to assign areas for E&P contracts is the Open Competitive Process.

These are the main steps of the process:

<table>
<thead>
<tr>
<th>Phase</th>
<th>Activities</th>
</tr>
</thead>
<tbody>
<tr>
<td>I. Divulgation and Information</td>
<td>(a) Launch of the Open Competitive Process</td>
</tr>
<tr>
<td>Phase</td>
<td>Activities</td>
</tr>
<tr>
<td>---------------</td>
<td>-----------------------------------------------------------------------------</td>
</tr>
<tr>
<td></td>
<td>(b) Sale of the information package</td>
</tr>
<tr>
<td></td>
<td>(c) Publication of the terms of reference</td>
</tr>
<tr>
<td></td>
<td>(d) Road shows</td>
</tr>
<tr>
<td></td>
<td>(e) comments and observations to the terms of references</td>
</tr>
<tr>
<td></td>
<td>(f) answer from the ANH regarding the comments to the terms of reference</td>
</tr>
<tr>
<td></td>
<td>(g) Formal opening of the Open Competitive Process and publication of the definitive terms of reference</td>
</tr>
<tr>
<td>II. Bidders’ Qualification</td>
<td>(a) observations to the definitive terms of reference</td>
</tr>
<tr>
<td></td>
<td>(b) answer from the ANH regarding the comments to the terms of reference</td>
</tr>
<tr>
<td></td>
<td>(c) Presentation of the documents for the qualification of the bidders</td>
</tr>
<tr>
<td></td>
<td>(d) Study of the documents and publication of the preliminary qualified bidders</td>
</tr>
<tr>
<td></td>
<td>(e) Comments to the preliminary qualified bidders</td>
</tr>
<tr>
<td></td>
<td>(f) Publication of the definitive list</td>
</tr>
</tbody>
</table>
**III. Presentation, Qualification and awarding**

(a) Submission of the proposals, bid bonds and public hearing

(b) Review of the proposal and publication of the preliminary eligibility list

(c) Comments to the eligibility list

(d) Publication of the definitive eligibility list and awarding

**IV. Signature of contracts**

(a) Awarding to the E&P Contracts

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### 7.2 Local Content Policy

The E&P model contract provided for the allocation of areas by the ANH establishes that the contractor must grant, in equal competitive conditions, a preferential right to local, regional and national suppliers of goods and services. The contractor has reporting duties, which include the information about local procurement among others, but there are no specific penalties for this obligation.

### 7.3 Special Tax Regimes

In Colombia there is a special exchange regime for the oil sector and for the services companies inherent to these sectors.

This special exchange regimen is provided in articles 48 to 52 of Resolution 8 of 2000 issued by the Board of Directors of Colombian Central Bank and implies that oil companies are not obliged to reintegrate to Colombian
exchange market the economic proceeds obtained from the sale made in foreign currency due to activities such as:

- Exploration and exploitation of oil, natural gas, coal and others,
- Services inherent to the hydrocarbon sector with exclusive dedication.

Also these companies are allowed to make payments in foreign currency to other oil subsidiaries/branches.

Article 16 of Law 9 of 1991 and Decree 2058 of 1991 establish those services which rendered in an exclusive manner to the oil sector are qualified as “service companies to the oil sector” and may consequently benefit from the special exchange regime.

**Special Customs treatments**

(i) With regards to the Customs duty

Colombian government has granted several incentives to the hydrocarbons and mining sectors aiming to encourage foreign investment. By means of Decree 562 of 2011 the government approved a customs duty exception of 50% of the current applicable tariff to the import of machinery, equipment and special tools destined to the exploitation, transport through pipes and refining of hydrocarbons but limited to the customs classification list included therein.

This exception shall be applicable until August 16th, 2015, unless the Government extends such date.

More recently, as per Decree 2682 of December 24, 2014 there is the possibility to declare the existence of Permanent Free Trade Zones anywhere in the national territory for offshore areas exclusively devoted to the technical evaluation, exploration and production of hydrocarbons in those areas. The free trade zone may also include continental areas needed
for logistics, compression, transformation and other activities directly related to the hydrocarbons offshore activities.

(ii) With regards to VAT

Pursuant to the Colombian Taxation Code and other applicable norms, the temporary import of heavy machinery for basic industries (i.e. mining, hydrocarbons, heavy chemistry, iron and steel industry, extraction metallurgy, power generation and transmission and acquisition of hydrogen oxide) does not levy VAT, to the extent such machinery is not manufactured in the country.

**Import with total or partial franchise of customs taxes**

Certain goods may be exempted to pay all custom taxes (custom duty and VAT) or part of them (custom duty or VAT, or when the applicable tariff has some sort of benefit or reduction) due to special treaties or laws adopted to such effect. This is called total or partial franchise.

(i) Based on laws

If the equipment to be imported is considered to be “heavy machinery for the basic industry” the franchise may be total, This means that there will be no VAT and eventually no custom duties if they fall within the list set forth in Decree 562 of 2011.

**Based on special Treaties (Double Taxation Treaty with)**

Colombia has signed double taxation treaties agreements with Canada and Mexico. Both agreements were negotiated based on the model and agreement to eliminate double taxation made by the Organization for Economic Cooperation and Development (OCDE).
8. **Environmental Liability**

According to Law 1333 of 2009 it is an offense in environmental matters any act or omission that constitutes a violation of the rules contained in the Renewable Natural Resources Code, Decree 2811 of 1974, Law 99 of 1993, Law 165 of 1994 and other provisions on environmental regulations that may replace or modify and administrative acts emanating from the competent environmental authority. Any environmental violations to the regulations or when an environmental damage has been caused, then the competent authority will be entitled to impose administrative fines after a due process of law, regardless of the eventual civil liability vis-a-vis third parties.

In environmental matters, it is presumed the negligence or fraud of the offender, which may lead to preventive measures which are immediately enforceable. These measures cannot be challenged and will be applicable without prejudice to the fines that might arise.

The offender has the burden of proving that he did not act with negligence or fraud in order to avoid the imposition of the administrative fines.

One of the fines which can be imposed is the "written warning" which consists of the written call attention to the person who allegedly violated the environmental standard without putting in serious danger the integrity or residence of natural resources, landscape and health. The warning may include attendance to obligatory lessons in environmental education. The alleged offender, who does not attend the lessons will be subject to a fine equivalent to five (5) legal monthly minimum wages (approximately USD 1,400).

The Ministry of Environment and Sustainable Development ("Ministry of Environment"), the Autonomous Regional Corporations, the Sustainable Development, Environmental Units and the Special Administrative Unit of
the National Parks System, will impose to the offender of environmental standards, according to the seriousness of the offense, by reasoned decision, one or more of the following sanctions:

1. Daily fines of up to five thousand (5,000) current legal monthly minimum wage, approximately USD 140,000,000.

2. Temporary or permanent closure of the establishment, construction or service.

3. Revocation or expiration of an environmental license, authorization, license, permit or registration.

4. Demolition work at the expense of the offender.

5. Final confiscation of specimens, exotic wildlife, and by-products, components, means or tools used to commit the offense.


7. Community work under conditions set by the environmental authority.

**Natural gas exploration, development production**

Natural gas E&P rights in Colombia are awarded along with crude oil E&P rights, so please refer to the corresponding section above. Specific regulation of the activity is set out in different norms, regulations resolutions of the different regulatory agencies in Colombia.

Nevertheless, it is worth mentioning that a new regulation regarding the domestic gas market was issued, which set out the following main provisions:

- If domestic demand for gas is higher than the offer of available amounts in three of the last five years as certified by the
Energetic and Mining Planning Entity - *Unidad de Planeación Minero Energética* ("UPME"), then oil and gas must be sold domestically under firm contracts made by public auction;

- pursuant to Decree 2100 of 2011, gas exports (including new export agreements) may be limited if the gas is needed to satisfy domestic supply. For these purposes, an indicator will be prepared considering certain factors, including, amongst others, current natural gas reserves, demand-side behavior, and exports and imports of gas. Such indicators will be calculated and published by the MME on July 30th of every year. So far, the MME has published this indicator only once (in September 2013), indicating that it was not necessary to limit gas exports.

The table below sets out some of the issues to be considered if domestic market obligations (MDO) are applicable:

<table>
<thead>
<tr>
<th>Issues</th>
<th>Colombian Regime</th>
</tr>
</thead>
<tbody>
<tr>
<td>DMO Extent</td>
<td>If conditions exist requiring the export of gas to be limited, producers will not be able to enter into any commitments for natural gas in respect of new export agreements, or to increase the amount of natural gas initially agreed in current export agreements.</td>
</tr>
<tr>
<td>Gas exports</td>
<td>- Gas may be freely exported under Decree 2100 of 2011. However, exports (including new export agreements) may be limited if the gas is needed</td>
</tr>
<tr>
<td>Issues</td>
<td>Colombian Regime</td>
</tr>
<tr>
<td>--------------------------------------------</td>
<td>---------------------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>to satisfy domestic supply as discussed above.</td>
<td>• Likewise, the E&amp;P model provides that, subject to applicable laws and regulations, the contractor is free to sell its production of hydrocarbons in Colombia, or to export abroad or to dispose of them as it sees fit.</td>
</tr>
<tr>
<td>Sale price of hydrocarbons sold in the domestic market</td>
<td>• Parties are free to determine hydrocarbon prices subject to the following restrictions:</td>
</tr>
<tr>
<td></td>
<td>o Prices of gas produced in the Guajira and Opon fields and sold domestically are capped by regulations issued by the CREG; and</td>
</tr>
<tr>
<td></td>
<td>o Prices of gas produced in new fields and sold domestically can be freely determined although the sale of gas under firm contracts must be made by public auction when the demand for gas is higher than the offer of available amounts in three of the last five years as certified</td>
</tr>
<tr>
<td>Issues</td>
<td>Colombian Regime</td>
</tr>
<tr>
<td>--------</td>
<td>------------------</td>
</tr>
<tr>
<td></td>
<td>by the UPME.</td>
</tr>
<tr>
<td></td>
<td>• Under E&amp;P model, if hydrocarbons are required to meet domestic market obligations, then prices for:</td>
</tr>
<tr>
<td></td>
<td>o crude oil will be calculated based on the international price, as provided in Resolution No 18-1709 of December 23, 2003 or in any legal or regulatory provision that modifies or replaces it;</td>
</tr>
<tr>
<td></td>
<td>o gas will be calculated based on the provisions set in Article 27 of Decree 2100 of 2011 (i.e. producers will be paid the opportunity cost by those agents who are not able to meet their commitments or did not contract sufficient firm capacity) or in any legal or regulatory provision that modifies or replaces it.</td>
</tr>
</tbody>
</table>
Unconventional resources

1. Legal Framework

As indicated above, Colombian legislation for oil and gas activities is mainly set forth in the Colombian Constitution, National Laws and administrative regulations issued by the MME and the ANH. The Key regulations for unconventional hydrocarbons in Colombia are:

- Agreement 02 of 2017, which sets out the main terms and conditions required to award hydrocarbons exploration and production areas;

- Agreement 03 of 26 March 2014, which builds on Agreement 004 of 2012 to include the terms and conditions required to award exploration and production contracts over unconventional resources such as shale oil and shale gas;

- the Colombian Petroleum Code as set out in Decree 1056 of 1953 and its later amendments;

- For unconventional sources, technical regulations and definitions are set out in MME Resolution 9 0341 of 2014; and

- Law 99 of 1993 and Decree 2041 of 2014, which constitute the environmental legislation in relation to hydrocarbon exploitation and production. The terms and conditions outlined in each concession’s environmental licence, also deal with these issues.

Agreement 02 of 2017 applies to both existing blocks with potential for unconventional resources as well as new blocks which have yet to be awarded. Therefore, if contractors who have been awarded blocks prior to 2017 wish to exploit and explore such blocks for unconventional resources, an additional contract would have to be entered into with the ANH in respect of such blocks. In addition, it is worth noting that these regulations
specifically exclude the exploration and exploitation of CBM, which will be subject to a different set of regulations which have not been sassed yet by the ANH.

2. **Key Exploration and Exploitation Terms**

2.1 **Exploration Term**

According to the Exploration and Production Agreement template (E&P model) currently in place, the exploration term is nine years as of the date of award. The term may be extended until the drilling, testing and completion of exploratory wells and/or until the acquisition of seismic programs have been completed, or for the purpose of continuing any exploration activities which were underway one month before termination of the relevant exploration phase.

There is also an evaluation period of a maximum of two years (if exploratory wells are drilled). If no exploratory wells are drilled, the evaluation period will be equal to one year, with a possible extension of one additional year if exploratory wells are subsequently drilled.

2.2 **Compulsory Relinquishments**

According to the E&P model, there is no mandatory return of exploration areas until the end of the exploration period for unconventional fields.

At the end of the nine year exploration period, allocated areas should be returned to the ANH, except for areas located for evaluation or production. In addition, at the end of the exploration period, and provided there is an area allocated for evaluation or production or a discovery made by the contractor and this has been duly notified to the ANH, the contractor may withhold 50% of the area (excluding the areas allocated for evaluation and for production) in order to carry out a subsequent exploratory program in the area retained. The subsequent exploratory program can be in two
phases of no more than 18 months each and must contain at least two exploratory wells for unconventional fields.

If within two years of having informed the ANH about the prospective potential for unconventional fields, the contractor has not performed exploration operations and, as the case may be, evaluation and development operations, the ANH may directly carry out activities in the area of this unconventional oil field, or assign it to a third party.

2.3 Exploitation term

Under the E&P model, the exploitation term runs for a maximum of 30 years upon declaration of commerciality. This can be extended for successive terms of 10 years and up to the economic limit of the field (i.e. until the net cash flow of the production operations are negative). If the exploitation period is extended beyond the original 30 year period, the contractor must pay the ANH 5% of total revenue generated from the sale of hydrocarbons associated with the relevant unconventional field (after deducting any amounts due to the ANH as a result of its participation and any applicable royalties).

2.4 Delineation Exploitation Area

According to E&P model, in its declaration of commerciality for hydrocarbons in unconventional fields, the contractor shall set out a detailed delimitation of the accumulation (volume, area extension, and the petro-physical and geo-mechanic characteristics thereof).

The area designed for production shall be delimitated by a polygon or by one or several regular geometric forms, as the case may be, which will comprise the field(s), the portion thereof located within the area assigned, plus a margin around each field not greater than 1 kilometer, provided it is within the area assigned.
If during the exploitation period, the contractor determines that a field extends beyond the area assigned for production, but within the current area assigned (excluding the areas returned), it may ask the ANH to expand the area allocated for production.

2.5 Water Resources Rights

At the material level the Ministry of Environment is responsible for environmental matters in Colombia. The Ministry of Environment is in charge of creating and implementing water resource management policies and regulations including pollution standards. It also manages protected areas and grants licenses to infrastructure projects requiring access to water resources.

At the regional level, the Corporaciones Autonomas Regionales (“CARs”) are responsible for implementing any national policies as well as managing natural resources within their communities. CARs are administratively and financially independent, but they receive some resources from the national government.

In relation to water resources, the main function of CARs is to efficiently allocate water resources to users, control water pollution, and create and implement programmes for the protection of the ecosystem. CARs are responsible for granting permits for water usage, which must be obtained before exploration commences.

2.6 Flaring

In principle, flaring and venting are prohibited. However, in particular cases, for security reasons or where it is not possible to economically recover the hydrocarbons, flaring is permitted subject to prior approval from the Ministry of Environment (Petroleum Decree of 1974, Resolution 18 1495 of 2009 and Resolution 18 0742 of 2012).
2.7 Fiscal Regime and Tax Incentives

During the exploitation period, the ANH collects royalties on a sliding scale from 8% to 25%. Typically, the lower the production, the lower the royalties owed. In addition, royalties for unconventional hydrocarbons are 40% lower than royalties applied to conventional hydrocarbons (Decree 4923 of 2011, Law 1530 of 2012).

Royalties are contributed to the General Royalties System (governed by the rules set out in Decree 4923 of 2011). This system aims to ensure the efficient use of revenue generated by the exploitation of non-renewable natural resources (e.g. to generate savings for the future). The General Royalties System distributes resources to various funds, beneficiaries and expenditure items, including the Savings and Stabilization Fund. This fund is utilized where amounts from the General Royalties System is less than the sum of the amounts required by the territorial pension savings, Science, Technology and Innovation Fund, Compensation Fund, Development Fund and direct assignments.

[Revised as of May 2018]
Mexico

Mexico Upstream Industry

1. Industry Background

On December 20th 2013, the government of Mexico published in the Official Federal Gazette a Decree that amended several provisions of the United Mexican States’ Constitution (“Mexican Constitution”) in the area of energy (“Reform”). The Reform became effective on December 21st, 2013.

Pursuant to the Reform, among other things, private companies are now able to invest in the oil and gas industry, and carry out hydrocarbon exploration and production activities. However, hydrocarbon ownership will still remain exclusively with the government of Mexico while in situ (i.e. underground).

Prior to the Reform, the activities related to exploration and production of hydrocarbons were reserved to the Mexican State. Such activities were exclusively carried out by the state owned company, Petroleos Mexicanos and its subsidiaries (collectively “PEMEX”), which were the only entities allowed to perform oil and gas exploration and production activities in Mexico. Private companies were restricted to providing services through works and services contracts with PEMEX and only received cash payments.

The Reform provides huge opportunities for private companies interested in participating in Mexico’s oil and gas industry. They can now do so through participation in international bids for competitive agreements, such as licenses, production sharing agreements, profit sharing contracts and service agreements. The Reform opens the oil and gas sector to new entrants, enhances competition and enables private companies to book
reserves and to document the oil and gas production in their financial statements.

1.1 Crude Oil Reserves

Mexico holds a sizable oil resource base. With an estimated of 7 billion barrels, the country ranks 19th in the world, behind Venezuela, Saudi Arabia, Canada, Iran, Iraq, Kuwait, United Arab Emirates, Russia, Libya, Nigeria the United States, Kazakhstan, China, Qatar, Brazil, Algeria, Angola, and Ecuador.

Proven Crude Oil Reserves,* 2017
Billion Barrels

* Reserves include gas condensate and natural gas liquids as well as crude oil.
Source: EIA 2018,
1.2 Natural Gas Reserves

Mexico also holds 12 trillion cubic feet of natural gas reserves, ranking 6th in the American continent, behind United States, Venezuela, Canada, Brazil, and Peru.

Natural Gas Proved Reserves, 2017
Trillion Cubic Feet

Source: EIA 2018.

1.3 Unconventional Resources

According to the Energy Information Administration, Mexico ranks 7th in the world with 13.0 billion barrels of unconventional oil resources, behind Russia, the United States, China, Argentina, Libya and Venezuela.
Top 10 Countries with Technically Recoverable Shale Oil Resources, 2013

Billion Barrels

- Russia: 75.0
- United States: 58.0
- China: 32.0
- Argentina: 27.0
- Libya: 26.0
- Venezuela: 13.0
- Mexico: 13.0
- Pakistan: 9.0
- Canada: 9.0
- Indonesia: 8.0

Total World: 345.0

Source: Technically Recoverable Shale Oil and Shale Gas Resources, EIA2013.

Also in shale gas, the country ranks 6th in the world with 545.0 trillion cubic feet of unconventional gas resources, following China, Argentina, Algeria, the United States and Canada.
Unconventional oil accounts for 17% of the total world reserves of crude oil and gas accounts more than a half of the total natural gas reserves. Mexico plays an important role in the global context, that can take generate economic advantages in its domestic business activities.
### Conventional* and Unconventional Oil and Gas Resources, 2013

<table>
<thead>
<tr>
<th></th>
<th>Crude Oil (Billion barrels)</th>
<th>%</th>
<th>Gas (Trillion cubic feet)</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Conventional Resources</td>
<td>1,687.9</td>
<td>83</td>
<td>6,557.8</td>
<td>47</td>
</tr>
<tr>
<td>Unconventional Resources</td>
<td>345.0</td>
<td>17</td>
<td>7,299.0</td>
<td>53</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>2,032.9</td>
<td></td>
<td>13,856.8</td>
<td></td>
</tr>
</tbody>
</table>

* Proved reserves.

Source: EIA 2013, BP 2014; Baker McKenzie analysis.

The greatest known shale potential is in the portion of the Eagle Ford shale that extends into Mexico’s Burgos basin from South Texas. This represents a great opportunity for Mexico to catch the potential benefits of the region in the long-run.

**Map of Basins with Assessed Shale (oil and gas) formations by Country 2013**

![Map of Basins with Assessed Shale (oil and gas) formations by Country 2013](image)

Source: Technically Recoverable Shale Oil and Shale Gas Resources, EIA 2013.
1.4  Crude Oil Production

During the period of 2006-2016, crude production in Mexico decreased at a compound annual rate of 3.7%. In 2006 production levels reached 3.68 million barrels while in 2016 the level was 2.45 million barrels. Meanwhile, oil prices decreased at a compound annual rate of 0.7%.

Crude Oil Production in Mexico 2006-2016
Million Barrels per Day and USD$ per Barrel

World Average Prices, * 2006-2016

* 2016 Average constant prices.

¹ The Mexican Ministry of Energy, for its acronym in the Spanish language.
1.5 Natural Gas Consumption

Within the period of 2006 and 2016, natural gas consumption in Mexico increased at a compound annual growth rate of 2.5%, given that in 2006 the consumption level reached 6.66 billion cubic feet per day while in 2016 the level was 8.95 billion cubic feet per day. Meanwhile, natural gas prices decreased to a compound annual rate of 4.3%.
Natural Gas Consumption vs US Henry Hub Price,* 2006-2016
Billion Cubic Feet per Day and USD$ per Million BTU

*Annual average prices

2. **Legal Framework**

Under Mexican legislation, there are several provisions and laws that govern and control the development of the oil and gas industry. Over the last couple years several administrative general provisions and other relevant regulatory provisions have been issued, to address particular matters within the oil and gas industry, such as the performance of surveys to obtain, use, interpret and market data from superficial
exploration activities, the use of data in possession of the National Hydrocarbons Commission, the midstream sector (e.g. natural gas transportation, distribution, storage, open access, etc.), among others. The main laws and regulations for Mexico’s oil and gas industry are described below.

2.1 The Mexican Constitution

As mentioned above, several amendments were made by the Reform to the Mexican Constitution, mainly to Articles 25, 27 and 28, which regulate Mexico’s energy sector. The amended Articles states as follows:

- **Article 25**: This article provides that the Mexican State shall guide, lead and coordinate the Nation’s economic activity, and will be in charge of the regulation and promotion of activities in accordance with the public’s demands, to foster the development of the national economy. Article 25 also provides that the public sector shall have the exclusive control of the strategic areas listed in Article 28 of the Mexican Constitution. It also states that as regards the exploration and extraction of hydrocarbons, the Mexican State shall perform such activities pursuant to the terms of Article 27.

- **Article 27**: This article provides that the Mexican State holds the exclusive direct domain over petroleum and all other hydrocarbons, whether solid, liquid or gas, located in the subsoil and expressly prohibits granting concessions to any individuals or private entities. However, this article states that the Mexican State is allowed to carry out the previously mentioned activities through assignations to PEMEX or by creating contracts with PEMEX or private companies. Article 27 further provides that PEMEX is allowed to enter into contracts with private companies.
• Article 28: This article lists as strategic economic areas, the activities related to exploration and exploitation of oil and other hydrocarbons. Article 28 further provides that such exclusive exploration and exploitation by the Mexican State of strategic economic areas included in this Article 28 shall not be considered as a monopoly.

These provisions of the Mexican Constitution are further regulated under many related laws and other regulatory instruments which together govern the oil and gas sectors, including the Mexican Foreign Investment Law (the “Foreign Law”) and North American Free Trade Agreement (“NAFTA”).

2.2 Hydrocarbons Law and its Regulations

The Hydrocarbons Law regulates the legal framework through which exploration and production of oil and other hydrocarbons occur in Mexico, as well as the processing and refining of oil and processing of natural gas. It also provides the regulation for transportation, storage, distribution, compression, liquefaction, decompression, regasification, commercialization and sale to the public of hydrocarbons, petroleum products and petrochemicals. The Hydrocarbons Law upholds the Nation’s ownership of hydrocarbons within the subsoil. It also states that activities of exploration and production of hydrocarbons are of public utility and will have preeminence over any other activity implying the use or benefit of the surface or subsoil of lands needed to perform these activities.

Moreover, the Regulations to the Hydrocarbons Law provide a broader legal framework for the processes through which hydrocarbons exploration and production can be performed in Mexico. Such legal instrument also provides the penalties related to actions that contravene the development of exploration and production activities.
Lastly, Regulations for the Activities under the Third Title of the Hydrocarbons Law, governs the procedures and requirements to secure permits for the activities of processing and refining of oil and processing of natural gas, exportation and importation of hydrocarbons and petroleum products, transportation, storage, distribution, compression, decompression, liquefaction, regasification, commercialization and sale to the public of hydrocarbons, petroleum products and petrochemicals.

### 2.3 Hydrocarbons Revenue Law and it Regulations

The purpose of the Hydrocarbons Revenue Law (the "HRL") is to establish the regime applicable to the revenue obtained by the Mexican State from contracts executed with private parties or from direct assignments to PEMEX to carry out the exploration and production of hydrocarbons, and to regulate the management and oversight of the financial aspects of such contracts.

This HRL establishes the concepts and mechanisms whereby the Mexican State is to obtain revenue from hydrocarbon exploration and production activities, resulting from contracts executed with private companies or assignments to state-owned enterprises (such as PEMEX).

In addition to establishing a detailed regime for the revenue to be received by the Mexican State, the HRL specifically provides the tax obligations applicable to contractors and/or assignees under the Income Tax Law and other laws.

Regulations to the Hydrocarbons Revenue Law provide the economic conditions and fiscal terms of the contracting modalities set out in the Hydrocarbons Law and certain provisions in connection with the management and rules for the fund for states and municipalities that produce hydrocarbons.
2.4 PEMEX Law and its Regulations

With this Law, PEMEX becomes a State Productive Company. PEMEX continues to be 100% owned by the Mexican State, but now it has budgetary autonomy and a special debt regime. In addition, its disputes are now to be resolved in accordance with commercial and civil law. The Board of Directors shall be comprised of five representatives of the Federal Executive Branch of Government and five independent members who are to be ratified by Senate. The CEO and all Board Members will be proposed by the Mexican President.

This Law grants special emphasis to (i) the development of new technologies for PEMEX, (ii) the partnership opportunity with third parties and (iii) a better corporate structure to be able to compete with the oil and gas companies that now will be able to begin operations in Mexico.

Regulations to the PEMEX Law mainly provide the rules for the appointment and removal of the members of the Board of Directors.

It shall be noted that on May 18, 2018, the Board of Directors of PEMEX issued new procurement provisions for its goods and services needs. It establishes a process-oriented regulations that seek to generate value procurement and supply. These provisions regulate jointly with the PEMEX Law and its Regulations the acquisition, leases, service procurements and work executions to be performed by PEMEX and its State Productive Subsidiaries.

2.5 Law of the Mexican Oil Stabilization and Development Fund (the “Fund”)

According to the Constitution, the Fund will serve to receive, manage and distribute revenue derived from the exploration and production of hydrocarbons, resulting from agreements entered by the Mexican State with third parties or by direct awards granted by PEMEX, establishing for such purpose a trust, which was created by the Ministry of Finance and
Public Credit as settlor and the Bank of Mexico as trustee, in accordance with the Fund Law.

The Fund Law establishes its main purpose, which is to receive, manage, invest and distribute revenue received by agreements entered into by the Mexican State with third parties or by a direct award by PEMEX.

2.6 **Law for the National Agency for the Industrial Safety and Environmental Protection of the Hydrocarbons Sector**

This Law regulates the National Agency of Industrial Safety and Environmental Protection of the Hydrocarbons Sector (ASEA) as a deconcentrated administrative organism of the Ministry of Environment and Natural Resources, with technical and procedural autonomy, in charge of regulating and supervising industrial and operative safety, as well as environmental protection in the case of certain regulated activities of the hydrocarbons industry, such as, a) surveillance and surface exploration, as well as the production and extraction of hydrocarbons; b) oil treatment, refining, transfer, marketing, transportation and storage; and c) natural gas processing, compression, liquefaction, decompression and regasification as well as its transportation, storage and distribution through pipelines.

2.7 **Federal Law to Prevent and Sanction Crimes Committed in Hydrocarbons Matters.**

The main purpose of this law is to establish particular offenses and penalties applicable in the field of hydrocarbons, petroleum or petrochemicals and other related assets. This law also provides a chapter directed to the prevention of the crimes established and described therein.
3. **Major Industry Players in Mexico**

3.1 **General Overview**

As a result of the Reform, there have been certain modifications to the government’s structural organization. These modifications include strengthened roles for existing Mexican authorities and regulatory bodies in the oil and gas sector, as well as the creation of new institutions.
3.2 Ministry of Energy ("SENER")

The SENER has the role of setting the energy policy and regulating the energy sector. The SENER, working jointly with the National Hydrocarbon Commission ("CNH") oversees and supervises the activities of exploration and production of hydrocarbons, as well as the processing, refining, importation and exportation of hydrocarbons. SENER is also responsible for determining the areas subject to exploration and production. On August 13, 2014, SENER assigned to PEMEX the fields it must explore, as part of the “Round Zero”.

3.3 Ministry of Environment and Natural Resources ("SEMARNAT")

The SEMARNAT is the body that provides environmental authorizations and provides specifications and regulations for environmental protection for the site preparation, construction, operation, maintenance and abandonment of natural gas distribution networks and all the hydrocarbons industry. Further to the Reform, it now has a new National Agency of Industrial Safety and Environmental Protection in the Hydrocarbons Sector (ASEA), under its control, and this new body oversees industry safety and environmental protections.

3.4 Energy Regulatory Commission ("CRE")

The CRE is a federal agency created in 1998 to enforce the natural gas and electricity laws and regulations. The CRE is an autonomous agency and regulates prices, rates and services, and focuses on the midstream and downstream sectors.

3.5 National Hydrocarbons Commission

CNH is a federal agency created by the 2008 reforms in Mexico and is responsible for regulating and supervising the upstream sector. The CNH collaborates with the SENER to determine national policy on hydrocarbons and provides specific regulations applicable to the upstream sector.
Pursuant to the Reform, it is the responsible for launching international bids for the award of granting instruments to both PEMEX and private companies, as it has been doing it so far on the three rounds of international public bids that have been conducted.

3.6 PEMEX

PEMEX now has a board of directors appointed by the President of Mexico and it is comprised of five members of the federal government and five independent members. PEMEX selected its existing assets under "Round Zero", obtaining the fields with the 83% of 2P reserves discovered and 31% of prospective resources in Mexico. PEMEX and As of 2017, PEMEX has not complied with the Exploration Plans of several areas awarded in "Round Zero". SENER and CNH granted PEMEX an extension of two more years, to comply with the minimum work commitments for the areas awarded in Round Zero.

3.7 National Natural Gas Control Center ("CENAGAS")

CENAGAS manages and operates the national natural gas integrated transportation and storage system (SISTRANGAS). CENAGAS purpose is to ensure the continuity and safety of services in the SISTRANGAS, in order to provide said services in strict compliance with the obligations of open access and without affecting the ownership of capacity reserve agreements. The SISTRANGAS is subject to five-year expansion plans proposed by CENAGAS and approved by SENER.

CENAGAS may issue a public tender for certain projects considered strategic in accordance with the Hydrocarbons Law, in which case the necessary infrastructure may be developed by third parties. CENAGAS is regulated by CRE and provides services to all operators, including PEMEX, on a non-discriminatory basis.
Moreover, CENAGAS is also in charge of coordinating the strategic projects to comply with the public policy of natural gas storage, which aims to create a natural gas reserve to improve the national supply in case of emergencies. The goal of these policies is to develop the infrastructure for natural gas storage necessary to store 45 billion cubic meters of natural gas, by the year 2026.

3.8 National Industrial Safety and Environmental Protection Agency for the Hydrocarbons Sector (“ASEA”)

ASEA was created during the Reform. Its purpose is to regulate and supervise the facilities and activities of the oil and gas sector regarding industrial and operative safety, as well as environmental protection.

3.9 Ministry of Finance and Public Credit (“SHCP”)

SHCP is responsible for determining the applicable fiscal terms applicable to each granting instrument, particularly in respect of taxes, royalties, etc. SHCP has created, as settlor, the Mexican Petroleum Fund for Stabilization and Development (managed by the Mexican Central Bank, as trustee).

3.10 Ministry of Economy (“SECON”)

SECON is responsible for the establishment of the goals and methodologies of local content for the oil and gas sector.

4. Acquiring Exploration and Production Rights

4.1 Bidding Rounds

As previously mentioned, further to Reform, the Mexican State maintains exclusive ownership over hydrocarbon resources (whether liquid, solid or gas) located in the subsoil. However, now there are new contracting modalities that are now contemplated, allowing the Mexican State to hire exploration and production services with private parties. Prior to the Reform, private parties acted as service providers for the oil industry,
through service contracts with PEMEX, receiving always and without exception payments in cash, which hindered the interest on the part of many contractors of entering into these types of agreements.

The energy reform introduced new contractual modalities that allows private parties to develop hydrocarbons exploration and production activities in Mexico. In certain contracting models (as explained below) private parties will be able to obtain as payment the extracted hydrocarbons. The awarding of agreements for exploration and production of hydrocarbons is being carried out through public tenders issued by CNH. These agreements may be formalized by the Mexican State (through CNH), with PEMEX or with private companies, either individually, through a joint venture or by consortium (which may include an association between PEMEX and private parties). The public tender procedure that private parties shall follow to be awarded with hydrocarbons exploration and production agreements is described with more detail in section 6 herein.

### 4.2 Granting Instruments

The HL provides contractual modalities that are more attractive and suitable for the international oil industry, in order to contract the exploration and production of hydrocarbons with private entities, such as:

**Profit sharing agreements:** allowing a private party to receive payments in cash, but unlike service agreements, the consideration will consist of a certain percentage of the net income obtained from the sale of hydrocarbons;

**Production sharing agreements:** allowing the private party to receive as payment a percentage of the production (in kind); and

**License agreements:** allowing the private party to receive, in exchange of a consideration, the onerous transfer of the hydrocarbons extracted from the subsoil.
The HL also includes service agreements for exploration and production. Additionally, it leaves open the possibility of implementing a combination of any of the contracting modalities described above. The consideration established in those agreements is subject to the provisions of the Hydrocarbons Revenue Law.

SENER is the authority in charge of electing the most adequate model of agreement for the hydrocarbons exploration and production tenders which are being called by CNH on behalf of the Mexican State. It is also the authority in charge, along with the assistance of CNH, to draft and design the model of agreements to be used under each tender.

The procurement regime has changed radically, and now private entities through shared production agreements or license agreements, may dispose of the resources extracted from the subsoil.

CNH will enter into exploration and production agreements either with private parties or with PEMEX. PEMEX may enter into alliances or partnerships to participate in the bidding processes for such contracts.

The HL allows for the execution of alliances or partnerships between private entities, in which case an operator shall be appointed amongst the members of any alliance or partnership. The operator may be replaced through an assignment, but to carry out this type of assignments, an authorization by CNH must be obtained, and such government agency must analyze, among other aspects, whether the proposed operator has the experience, technical and financial capabilities required to direct and perform the activities in the contracted area.

**NOC participation**

The HL provides that if there is a possibility of finding cross-border oil reserves, the participation of PEMEX in the respective project will be mandatory, and such participation shall be with an interest of at least 20% in the project. The HL also provides certain scenarios in which PEMEX’s
participation in hydrocarbons’ exploration and production may be included, and such participation may not exceed an interest of 30% in the corresponding project. Such scenarios include:

- When the tendered Contracted Area coexists, in a different depth, with an Assigned Area (those granted through an entitlement in favor of PEMEX or other State Productive Companies);

- When there are opportunities for the development and transfer of knowledge and technology in favor of PEMEX or any other State Productive Company; or

- When the Contracted Area is related to projects to be developed through an special financial vehicle of the Mexican State.

5. **Government Takes**

Private companies in the oil industry are obligated to pay taxes as any other tax contributor. Companies that carry out business in the Mexican oil industry, contribute to the Mexican treasury by paying taxes, as required to any regular business activity in Mexico.

5.1 **Federal Taxes**

5.1.1 **Income Tax**

The first Article of the Mexican Income Tax Law (“MITL”) provides that Mexican tax residents and non-Mexican residents with a permanent establishment in Mexico, are required to pay income tax on all of their income, notwithstanding the source of such income. The corporate income tax rate in Mexico is 30% of the net income.
In general terms, according to the MITL, the tax payable for the year is calculated as follows:

<table>
<thead>
<tr>
<th></th>
<th>Gross income for the tax year.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(-)</td>
<td>Authorized Deductions and mandatory employee profit sharing</td>
</tr>
<tr>
<td>(=)</td>
<td>Tax Profit</td>
</tr>
<tr>
<td>(-)</td>
<td>Tax Losses (NOL's)</td>
</tr>
<tr>
<td>(=)</td>
<td>Tax basis</td>
</tr>
<tr>
<td>(x)</td>
<td>Tax rate (30%)</td>
</tr>
<tr>
<td>(=)</td>
<td>Income Tax payable</td>
</tr>
</tbody>
</table>

**Profit Sharing**

In accordance with the Mexican Constitution and with the Federal Labor Law, companies will be required to pay profit sharing ("PS") to their employees, in accordance with the profits generated each year. The PS will be determined at the rate of 10% of such profits. Notwithstanding the foregoing, since 2005, companies are able to deduct the PS paid on the corresponding tax year, for income tax purposes.

**Authorized Deductions**

In order to determine the annual income tax, taxpayers are entitled to claim diverse authorized deductions, being the most important: (i) refunds received or discounts or rebates taken in the fiscal year; (ii) cost of goods sold; (iii) expenses net of discounts, rebates or refunds; (iv) investments (see next paragraph); (v) non-performing credits; (vi) interests accrued chargeable to the taxpayer fiscal year; and (vii) the deductible inflation. Deductions must qualify as “strictly indispensable” for the taxpayer’s...
business activities, and must also meet a number of requirements. In the case of deduction of payments made to residents abroad, it shall meet additional requirements to allow the deduction of such payments (such as the new BEPS Rules).

In case of deduction of investments, it is applicable the straight-line method (depreciation fixed assets and to amortize intangible assets). The deduction has to be computed using the annual percentages set by MITL, and is computed on original cost of fixed assets, with the amount of depreciation indexed for inflation.

**Tax Return Filing**

Taxpayers shall to submit its tax return on March 31 of the following year to which the tax payment corresponds. Also, taxpayers are required to make monthly estimated payments on account of the annual tax. These payments are made on the seventeenth day of the month immediately following that to which the payment corresponds.

### 5.1.2 Value Added Tax

Mexico imposes a value added tax ("VAT") on all sales of goods, rendering of services, importations, and temporary use or enjoyment of goods, performed in Mexico. The general rate is 16% of the value of the product, rental or service. The VAT in Mexico is a non-cumulative turnover tax imposed on products at each stage of their production and commercialization, from raw materials to the ultimate consumer, based on the value-added to the product at each stage. Thus, companies must add the VAT to the sales price of their products or services, collect it from their customers, and in turn pay VAT to their own suppliers.

**Tax Return Filing**

The VAT that is paid to suppliers is deducted from the VAT charged to customers. As such, the amount that companies must remit to the
government is the excess of the total VAT collected during the tax period from their customers over the creditable VAT paid to their suppliers (the creditability concept will be further explain below). In general terms, the VAT shall be computed by calendar month. VAT returns and payment in full are due by the 17th day of the month following the end of the return period.

*Creditable VAT*

The VAT law contains a mechanism to determine the creditable VAT. The crediting mechanism of the VAT system consists of subtracting the creditable tax from the amounts collected. Creditable tax is understood to be an amount equivalent to the VAT that has been charged to the taxpayer along with any VAT paid related to the importation of goods or services during the tax year.

In order for VAT paid to be creditable, the VAT must correspond to goods or services which are strictly related to VAT taxable activities to be carried out by the taxpayer, including 0% rated activities. In addition, creditable VAT paid by the taxpayer must be related to activities, which are deductible for income tax purposes in Mexico.

As a general rule, in order to determine the creditable VAT, the taxpayer must ascertain its VAT taxable acts or activities and its VAT non-taxable activities (exempts). Subsequently, the taxpayer must determine its creditability factor. That is, the proportion of taxed and exempt acts that the company should use to obtain the creditable amount. This procedure provides that the taxpayer should determine its activities subject to VAT (VAT taxable acts or activities) and divide these activities by the total amount of activities performed by the company (VAT taxable acts or activities plus exempt acts or activities).
5.2  **State Taxes**

5.2.1  **Taxes on payroll**

Entities are subject to a local state payroll tax the rate of which will depend on the location of the working facilities. Generally, the tax rate is between the 2% and 3% on the payroll.

5.2.2  **Taxes on Property**

The transfer tax is also a municipal level tax and is levied against individuals or entities acquiring real property within a given municipality. The transfer tax is charged only once to the individual or entity acquiring real property or real estate rights, as applicable, payable at the time of the acquisition. The rate is set by state law and most states assess the tax at a rate of 2% of the purchase price.

Property tax or Predial is a municipal level tax that is levied on individuals or companies who own, and in some states are in possession of, real property located within a given municipality. The applicable tax rate varies depending on each specific municipality and the underlying valuation methodology of the real property in question varies, although it is commonly based on the so-called “cadastral” value.

6.  **Procurement of Goods and Services**

As mentioned previously, in Mexico, the assignation of areas for E&P contracts is through public tender procedures.

These tender procedures are mainly regulated by the HL, its Regulations and the administrative provisions regarding hydrocarbons exploration and production tenders issued by CNH on November 28, 2014, which regulates the minimum stages that these kind of tenders shall contemplate when participating.
6.1 Public Tender

The main stages of the tender procedures in which interested parties shall participate for the awarding of hydrocarbons exploration and production agreements in Mexico are explained below:

**Publication of the Call for Tenders.** In this stage, CNH publishes in the Mexican Federal Official Gazette the Call for Tenders, inviting private parties and State productive companies to participate in tenders for the awarding of hydrocarbons exploration and production agreements. Once this occurs, the tender procedure officially commences. The Call for Tenders shall at least contain the legal basis of the tender, the electronic address where the Bidding Guidelines can be obtained and the name and position of the public officer issuing the Call for Tenders.

**Publication of the Bidding Guidelines.** The Bidding Guidelines contain all the rules and special provisions that interested parties shall attend when participating in the tenders. These are usually issued in the same day in which the Call for Tenders is published. The minimum content of the Bidding Guidelines include, among others:

(i) General information of CNH;

(ii) Purpose of the tender;

(iii) Model of agreement to be awarded;

(iv) Calendar of the tender;

(v) Contractual area(s) to be awarded;

(vi) Prequalification criteria and documents;

(vii) Awarding mechanism;

(viii) Requirements for the submission of proposals;
(ix) Required guarantees; and

(x) Events in which proposals shall not be considered or shall be rejected.

**Data Use Licenses.** During the first tenders, CNH used to provide access to a Data Room to the parties interested in participating in a bid, in order to review the available information regarding the contractual areas to be awarded under each tender and to have the elements required to submit their proposals. However, now the CNH grants a data use license for the interested parties to utilize and access specific information regarding the contractual areas to be awarded under a tender. Interested parties shall make a payment in favor of CNH to secure the license. Once the payment is made and certain administrative procedure is conducted, interested parties shall have access to the information acquired under the respective license, during a limited period of time.

**Clarification Stages.** In these stages, CNH will answer questions submitted by parties interested in participating or already participating in the tender and that are related to procedure, pursuant to the terms provided under the Bidding Guidelines. Answers by CNH to submitted questions shall be published in the web page of the tender. Participation in these clarification stages is optional for the interested parties.

**Pre-qualification.** Under this stage, interested parties shall submit before CNH the information and documentation that evidences its experience, as well as its technical, financial, legal and operating capacity. After such information and documentation is submitted, CNH shall evaluate each interested party, to verify its experience and capacities and further CNH shall inform the parties that will be able to continue participating in the tender procedure and that may submit proposals for the awarding of the contractual areas. In certain tenders, interested parties are able to pre-qualify as operators or only as non-operators.
Authorization to Integrate Bidders. Only those pre-qualified parties may request CNH for the authorization to integrate bidders, whether individually or jointly as a consortium with other entities.

Submission and Opening of Proposals. Only those authorized bidders may submit proposals and only one proposal per contractual area may be submitted by each party (either individually or as part of a consortium). Once the submission process is commenced, parties shall not withdraw their proposals. Bidding Guidelines of each tender shall specify the specific details and requirements for submitting proposals (e.g. number of copies, numbering, form of submission, date of submission, etc.).

Award. Once proposals are submitted by each party and evaluated by CNH, such entity shall issue the award minute on the date provided in the Bidding Guidelines of each tender. The award minute shall contain the name of winning bidder, the name of the second place bidder and the term for entering into the agreement for the exploration and production of hydrocarbons and for submitting the required guarantees. CNH may revoke the award if it is evidenced that the winning bidder submitted false information.

Execution of the Agreement. In the term provided under the award minutes, winning bidders shall enter into the agreement for the exploration and production of hydrocarbons in the corresponding contractual areas. It is important to note that in accordance to the provisions of the HL, this type of agreements shall only be entered with State productive companies or Mexican companies (Mexican tax residents), meaning with this that if the winning bidder is a foreign company, it shall create an SPV in Mexico to execute the agreement. Moreover, before entering into the agreement, certain administrative documentation shall be submitted, such as guarantees, articles of incorporation and powers of attorney.
6.2 Local Content Policy

The HL provides that exploration and exploitation activities must reach, on average, a local or domestic content of 35%. Each contract or assignment establishes the percentage of national content to which each contractor or assignee will be subject to, which will be complied individually and progressively.

The HL provides that the goal of 35% of local content for hydrocarbons exploration and exploitation activities shall not apply to such activities conducted in deep and ultra deep waters, which particular goal shall be established by the Ministry of Economy. On March 29, 2016, the Ministry of Economy published in the Federal Official Gazette the resolution by which local content values are determined for hydrocarbon exploration and extraction activities in deep and ultra-deep waters. The local content applicable to deep and ultra-deep waters to be met progressively up to 2025 is equivalent to 8%.

6.3 Special Tax Regime

In addition to establishing a detailed regime for the revenue to be received by the Mexican State, the HRL specifically provides the tax obligations applicable to contractors and/or assignees under the Income Tax Law and other laws.

The main HRL’s provisions affecting private entities interested in entering into contracts with the Mexican State for hydrocarbons exploration and production are summarized below.

6.3.1 Income from exploration and production activities

As stated above, as a result of the Reform, the Mexican State may execute the following types of agreements with private enterprises for hydrocarbon exploration and production:
1. License agreements;
2. Profit sharing agreements;
3. Production sharing agreements; and

In this context, the Mexican State may derive revenue from the consideration payable under each agreement (in addition to the fees for assignments with state-owned companies). The consideration and fees will be payable to the Mexican Oil Fund according to the mechanisms provided in the HRL, in each contract, or in other applicable provisions.

The following table summarizes the regime applicable to each of the above agreements, pursuant to the HRL:

<table>
<thead>
<tr>
<th>Modality of Agreements</th>
<th>Contractor’s compensation</th>
<th>Government’s compensation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Transfer of title</td>
<td>Cost recovery</td>
</tr>
<tr>
<td>License</td>
<td>Total</td>
<td>✓</td>
</tr>
<tr>
<td>Production Sharing</td>
<td>Partial</td>
<td>✓ In kind</td>
</tr>
<tr>
<td>Profit Sharing</td>
<td>✓ Cash basis</td>
<td>✓ Cash basis</td>
</tr>
<tr>
<td>Services</td>
<td>✓ Cash basis</td>
<td>Cash basis</td>
</tr>
</tbody>
</table>

### 6.3.2 Entities that may be contractors

Under the HRL, only state-owned enterprises or entities created under Mexican law that are residents for tax purposes in Mexico, whose sole corporate purpose is hydrocarbon exploration and production, and which are not taxed under the special integration regime in the Income Tax Law, may be contractors under any granting instrument awarded by CNH.
Therefore, companies residing outside Mexico for tax purposes, whether because they were created under foreign law or are vehicles whose principal place of business or place of effective management is outside national territory, may not be contractors and they shall incorporate a Mexican subsidiary to become a party to any granting instrument.

### 6.3.3 Fiscal Aspects of the HRL

The HRL does not contemplate a special tax regime for oil and gas contractors. They will be subject to the income tax, value added tax ("VAT") and other taxes under applicable laws, like any other corporate taxpayer. However, there are certain special incentives and taxes applicable to oil and gas contractors, for contractors for income tax as discussed below.

#### Ring Fencing

The HRL allows a contractor to have more than one agreement. However, one same entity acting as contractor under two or more contracts, may not "consolidate" profits and losses generated in such agreements for purposes of the special taxes and levies provided under the HRL.

#### Depreciation rates

In lieu of applying the general depreciation rates set forth in Articles 33 and 34 of the Income Tax Law, oil and gas contractors should apply the rates provided in Article 32 of the HRL, as follows:

- 100% of the original amount of investments for exploration, secondary and improved recovery, and non-capitalized maintenance in the year in which made;
- 25% of the original amount of investments for the development and exploitation of oil or gas deposits, each tax year, and
• 10% of the original amount of investments in storage infrastructure and transportation as needed for contract performance, such as the oil and gas pipelines, terminals, transportation or storage tanks necessary to convey the contractual production to the delivery, metering or inspection points determined in each contract, every tax year.

**VAT**

The HRL provides that exploration and production activities are zero rated for VAT purposes. The 0% rates only applies to agreements between the Mexican State and state-owned enterprises or entities, and do not apply to any other agreement executed with third parties, even in the case of exploration and production contracts.

**Employees profit sharing**

Contractors that execute exploration and production contracts under the HRL must pay 10% of profits to their employees.

**Tax on hydrocarbon exploration and production activities**

This tax was created to be levied on oil and gas contractors and their assignees as a fee payable per square kilometer of assigned area as follows:

• $1,688.74 * pesos during the exploration phase; and

• $6,754.99* pesos during the production phase.

The tax is to be paid on a monthly basis.

*updated up to the year 2018
Consortium Tax Regime

The HRL establishes a new tax regime for entities involved in agreements through a consortium. This regime enables each member of the consortium to directly recognize project income and costs as a function of their percent share, whereby each party is taxed individually for income tax purposes. For these purposes, one of the parties will be named as operator, with a series of formal reporting obligations and other requirements relating to the issuance and receipt of tax invoices.

6.3.4 Tax Regime for Hydrocarbons Exploration and Production Agreements

For better understanding of the tax regime of each model of agreement, below you can find the charts that explain the flow of each.

License Agreement
Product Sharing Agreement

Profit Sharing Agreement

Service Agreement
**6.4 Ronda Uno bidding procedures**

In December 11th, 2014, the Call for Tenders No. CNH-R01-C01/2014 was issued by CNH and published in Mexico’s Federal Official Gazette, for the development of hydrocarbons exploration and production activities in shallow water fields located in south-east Mexico, through the execution of production sharing agreements (the “First Tender”). This represented the beginning of Ronda Uno, which is a series of tenders to be called to award hydrocarbons exploration and production agreements. It also meant the first business opportunity for those Mexican and international private companies interested in participating in hydrocarbon exploration and activities in Mexico.

As a result of the First Tender, on July 15th, 2015, only two out of fourteen production sharing agreements were awarded.

On February 25th, 2015 the second Shallow Waters Tender No. CNH-R01-C02/2015 (“Second Tender”) was issued by CNH and published in Mexico’s Federal Official Gazette. For this Second Tender, 3 out of 5 blocks were awarded to different international private parties, being a great success for the Mexican authorities and the domestic oil & gas industry.
For the First Tender and the Second Tender, SENER appointed the production sharing agreement as the most appropriate granting instrument.

On May 12th, 2015, the Call for Tenders No. CNH-R01-C03/2015 (“Third Tender”) was issued by CNH and published in Mexico’s Federal Official Gazette, for the awarding of license agreements for hydrocarbons extraction in onshore contractual areas. Such Third Tender included 25 onshore blocks which all of them were awarded on December 15th, 2015. This represented the first license agreement tender to be called after the implementation of the Reform.

On December 17, 2015, the CNH published in Mexico’s Federal Official Gazette the Call for Tenders No. CNH-R01-C04/2015 (“Fourth Tender”) for the awarding of license agreements for hydrocarbons exploration and extraction in deep waters contractual areas. For the Fourth Tender 8 out of 10 deep waters contractual areas were awarded in December 5th, 2016. The 8 awarded contracts represent an approximated inversion of 34.4 billions of dollars during the next 35 years.
Below please find a map showing each of the 10 contractual areas located in deep waters of the Gulf of Mexico:

6.5 *Ronda Dos* bidding procedures

On July 20th, 2016, the call for Tenders No. CNH-R02-C01/2016, was issued by CNH and published in Mexico’s Federal Official Gazette, for the development of hydrocarbons exploration and production activities in shallow water fields located in the cost of Veracruz, Tabasco and Campeche, through the execution of production sharing agreements. This represented the beginning of *Ronda Dos*. As a result of the Ronda Dos First Bid, on June 19th, 2017, 10 out of 15 blocks were awarded.

Below please find a map showing each of the 15 contractual areas located in deep waters of the Gulf of Mexico:
On August 23rd, 2016, CNH published in the Mexico’s Federal Official Gazette the Call for Tenders No. CNH-R02-C02/2016 for the awarding of license agreements for hydrocarbons exploration and extraction in onshore contractual areas. As a result of the Second Tender of *Ronda Dos*, on July 12th, 2017, 7 of 10 contractual areas located in the north-east and south-east of Mexico, were awarded by the CNH.
Below please find a map showing each of the 10 contractual areas issued by the Second Bid of *Ronda Dos*.

On November 15th, 2016, the Call for Tenders No. CNH-R02-C03/2016 was issued by the CNH and published in the Mexico’s Federal Official Gazette for the development of hydrocarbons exploration and production activities in onshore fields, through the execution of production sharing agreements. For the Third Bid of *Ronda Dos*, all of the 14 onshore blocks were awarded on July 12th, 2017.
Map showing the 14 contractual areas awarded to national and international companies for the hydrocarbon exploration and production activities in onshore field, as shown below:

On July 20th, 2017, CNH published in the Mexico’s Federal Official Gazette the Call for Tenders No. CNH-R02-C04/2017 for the awarding of license agreements for hydrocarbons exploration and extraction in deep water fields located in the Gulf of Mexico, through the execution of license agreements. As a result of the Fourth Tender of Ronda Dos, on January 31st, 2018, 19 of 29 contractual areas were awarded by the CNH. The 19 awarded contracts represent an approximated inversion of 93 billions of dollars for the hydrocarbon exploration and extraction.
Below please find a map showing each of the 29 contractual areas issued by the Second Bid of *Ronda Dos*.

### 6.6  *Ronda Tres* bidding procedures

On September 28th, 2017, the call for Tenders No. CNH-R03-C01/2017, was issued by CNH and published in Mexico’s Federal Official Gazette, for the development of hydrocarbons exploration and production activities in shallow waters, through the execution of production sharing agreements. This marks the beginning of Ronda Tres, with 35 contractual areas for a total area of 26,265 km², located in the Gulf of Mexico. As a result of the *Ronda Tres* First Bid, on March 27th, 2018, 16 out of 35 blocks were awarded.
Below please find a map showing each of the 35 contractual areas issued by the First Bid of *Ronda Tres*.

On April 25th, 2018, CNH published in the Mexico’s Federal Official Gazette the Call for Tenders No. CNH-R03-C02/2018 (Second Bid of Ronda Tres) and CNH-R03-C02/2018 (Third Bid of *Ronda Tres*) for the awarding of license agreements for hydrocarbons exploration and extraction in onshore fields, through the execution of production sharing agreements.
The Second Bid of *Ronda Tres* includes 37 onshore blocks located in Tamaulipas, Tampico, Veracruz and Campeche. The respective bids for the Second bid, will be submitted in February 14, 2019.

The Third Bid of Ronda Tres consists in 9 contractual areas for onshore blocks, located in Tamaulipas. SENER estimates an approximated inversion of 2,343 billions of dollars during the next 40 years, if the 9 onshore blocks are awarded. The respective bids for the Third Bid, will be submitted in February 14, 2019.

### 6.7 Farmouts bidding procedures

The HL allows private entities to participate in farmouts or alliances with PEMEX, in bidding procedures for the hydrocarbon exploration and production activities. This gives, both, PEMEX and private entities, the possibility of partnering in order to develop fields with the best international practice and at the same time to share costs and risks.

On December 16, 2016, CNH published in the Mexico's Federal Official Gazette the Call for Tenders No. CNH-A1-TRION/2016 for the alliance with PEMEX for the development of hydrocarbon exploration and production activities in deep waters. Trion area represents 1,285 km² and it would have, according to some estimates, a production of 485 million barrels of oil.

The results of PEMEX first farmout, were published on May 3, 2017, being awarded BHP Billiton.
Below please find a map of the contractual area of tender No. CNH-A1-TRION/2016:

On March 7, 2017, the Call for Tenders No. CNH-A2-AYIN-BATSIL/2017 was issued by CNH and published in the Mexico’s Federal Official Gazette, for the development of the hydrocarbon exploration and production activities in alliance with PEMEX. CNH-A2-AYIN-BATSIL/2017 was declared void by the lack of participants.

On May 2nd, 2017, CNH published in the Mexico’s Federal Official Gazette the Call for Tenders No. CNH-A3-CARDENAS-MORA/2017 and CNH-A3-OGARRIO/2017, for the development of hydrocarbon exploration and production activities in onshore fields. On October 17, 2017, the results were published by CNH.

Tender No. CNH-A3-CÁRDENAS-MORA/2018, represents an area of 168.15 km², with an estimated production of 93.2 million barrels of oil and it was awarded in favor of PICO Cheiron Group.
Please find below a map of the contractual area for Tender No CNH-A3-CÁRDENAS-MORA/2018:

Tender No. CNH-A4-OGARRIO/2018 represents an estimated of 53.7 million barrels of oil, on an area of 155.99 km² and it was awarded in favor of DEA.

Below please find a map of the contractual area of Tender No. CNH-A4OGARRIO/2018:
On September 18, 2017, the Call for Tenders No. CNH-A5-NOBILIS-MAXIMINO-C4/2017 was issued by CNH and published in the Mexico’s Federal Official Gazette, for the development of the hydrocarbon exploration and production activities in alliance with PEMEX. CNH-A5-NOBILIS-MAXIMINO-C4/2017 was cancelled on December 7, 2017, since CNH considered that there were no interested parties that could and/or wanted to continue participating in the tender process.

The Call for Tenders CNH-A6 was published by CNH on April 26, 2018, on the Mexico’s Federal Official Gazette, for the awarding of license agreements for hydrocarbons exploration and extraction in seven onshore fields. The seven license agreement to be awarded under this bid, represent a total area of 4,580.8 km². The submission of bids will take place on February 14, 2019.

Please find below a map of the contractual area for Tender No. CNH-A6.

7. Environmental Liability

Oil is regarded by Mexican law as a hazardous substance and/or waste, and therefore the standard provisions for soil pollution from hazardous waste
will be applicable in the event of any spill, leak or accident involving hydrocarbons.

Even though a basic principle of Mexican environmental law is “the polluter must pay remediation”, in case of soil pollution due to hazardous waste, the owner and/or possessor of the site will be considered by environmental authorities as liable for purposes of performing remediation activities, even if such owner or possessor did not cause the contamination. However, owner or possessors may seek indemnification of remediation costs from the actual polluters by means of litigation.

In the event of oil spills which exceed one cubic meter, the Environmental Protection Bureau must be notified and remediation must proceed, following the requirements of the General Law for the Prevention and Integral Management of Waste and its Regulations. In the event of accidents involving a lower volume, even if it is not mandatory to give notice, the remediation procedure specified in the Regulations must be followed.

Official Mexican Standard NOM-138-SEMARNAT/SS-2003 establishes maximum allowable limits for hydrocarbons in soil. If such thresholds are exceeded, soil remediation is required.

With respect to water pollution, there are no applicable standards establishing pollution thresholds, such as those existing for soil pollution, and usually a risk analysis must be undertaken to verify if remediation is required.

Besides civil liability, administrative and criminal liabilities may be applicable in the event of soil pollution or damages to third parties, caused by environmental accidents or oil spills.
Natural Gas Exploration, Development Production

The upstream natural gas industry is regulated under the same provisions described above.

Change of Federal Administration

On July 1st, 2018, Andres Manuel López Obrador (AMLO, for its acronym in Spanish) was elected as the new President of the United Mexican States for the next 6 years (2018-2024). AMLO will formally take office on December 1, 2018. One of his proposals for the energy sector, according to his Plan of Nation, consists in the review of all of the oil and gas industry and its legal framework, and particularly the review of the award process of the granting instruments already executed. Therefore, certain changes could be expected in the legal and regulatory framework of the energy industry.

[Revised as of July 2018]
The Upstream Business

In 1992, the Peruvian Government began deregulating many sectors of the economy in which, through State-owned companies, it was the main player. Hence, an important privatization process began as part of a significant economic reform destined to make Peru attractive to foreign investors. The Constitution of 1993 (“Peruvian Constitution”) was the first step, as it established several guaranties to investors, both national and foreign, and a clear economic policy which fostered competition among private investors, and restricted government’s business activities to only when it was authorized by law and subsidiarily to the private activity, due to public interest or manifest national convenience.

In the case of the oil and gas industry, until 1993, the main player was the national oil company (NOC), Petróleos del Perú S.A. (“Petroperu”), which had control of all the activities in the oil industry from the upstream to the downstream. In addition to this, access of direct foreign investment to upstream activities was restricted. At that time, investment on exploration activities was low and the production and reserves were in decline. Peru became a net importer of oil, while most of the country’s territory remained unexplored.

Faced with this situation, new conditions were required to reactivate exploration activities in Peru. As for other industries, the Peruvian Government decided to open the industry to private and foreign investment, by publishing the Hydrocarbons Organic Law (Law No. 26221, hereinafter the “HOL”).

At the same time, Petroperu’s participation was reduced to the operation of some refineries, the distribution of fuel and the operation of an oil pipeline. Its participation in the upstream was transferred to private oil companies, most of them foreign. In addition, new rules establishing clear
and equal conditions for all those interested in participating in oil and gas activities were implemented, together with a firm commitment from the Peruvian Government to avoid arbitrary changes on the legal framework.

As a result, there are currently several foreign oil companies, including some foreign national oil companies (such as Ecopetrol from Colombia, Sonatrach from Algeria, China National Petroleum Corporation - CNPC- from China, and Korea National Oil Corporation - KNOC- from Korea), beside other world-class companies (such as CEPSA, Repsol, SK Energy and Woodside), participating actively in the upstream, performing exploration and production activities, and also enabling the rapid development of a natural gas industry, mainly supported by the natural gas reserves located in the Camisea basin in Cusco.

1.1 Major Industry Players

The northern coast of Peru has been actively producing oil for over 150 years. It has the oldest producing fields in the region. The main players in this area are CNPC, Graña y Montero Petrolera and Olympic.

Savia (which is a joint venture between Ecopetrol and KNOC) and BPZ (which has a joint venture with Frontera Energy) have offshore producing wells, while others like Anadarko and Karoon are performing exploration activities in the continental shelf.

In the northern and central jungle, the main producers are Pluspetrol and CEPSA. Other major developments in the jungle are the natural gas discoveries made by Repsol in Block 57 and CNPC in Block 58, both in the Camisea basin, which added to the current Block 88 & 56 reserves, make jointly 97% of the total Peruvian natural gas proven reserves.

In 2013, Petroperu returned to the upstream by acquiring from Talisman and Hess their interest on Block 64, in the Northern Jungle, in which they made a discovery of oil. Then, in 2016 Petroperu has partnered with Geopark for the operation of this block.
Also, Petroperu was qualified to operate Block 192 in the Northern Jungle (formerly operated by Frontera Energy), which is the most important production block in the country (total proven reserves of approximately 100,000 bbl), and is looking for an investor partner to start the activities’ development in this block.

1.2 Relevant Governmental Authorities

The following are the most relevant Peruvian governmental entities involved in upstream operations:

- **PERUPETRO S.A. ("PERUPETRO"):** A State-owned company subject to private law which, on behalf of the Peruvian Government, has the following functions:

  (a) Promotes investment in the exploration and exploitation of hydrocarbons.

  (b) Calls for bidding rounds to award agreements for the exploration and exploitation of hydrocarbons.

  (c) Negotiates and executes (with the authorization of the Peruvian Government) agreements to grant ownership over the extracted hydrocarbons (License Agreements) or to retain services (Service Agreements).

  (d) Collects the payment of royalties in the case of License Agreements.

  (e) PERUPETRO and the oil company will form a Supervision Committee (led by PERUPETRO) which, among other purposes, will allow both parties to exchange information about the operations, to assess the execution of the exploration minimum work programs and the production annual work program, as well as to verify and coordinate
the execution of the works and the compliance of all the obligations related to the operations foreseen in the Agreement or agreed by both parties.

- **Ministry of Energy and Mines ("MEM")**: The MEM guides, develops, manages and monitors national policies, plans, programs and budget of the Energy and Mines Sector. It proposes and/or issues the necessary regulations applicable to the hydrocarbons industry, promoting the exploration, production, storage, processing, transportation, distribution and commercialization of hydrocarbons.

- **Vice ministry of Hydrocarbons**: Headed by the Vice minister of Hydrocarbons, is responsible of the MEM functions on hydrocarbons matters, as well as to supervise and execute the national policies on such regard.

- **General Hydrocarbons Bureau ("GHB")**: The GHB is the technical regulatory body that participates in the formulation of the promotion and regulatory policies that rule the exploration, production, transport, storage, refining, processing, distribution and trading of hydrocarbons. Among other functions, the GHB formulates and proposes the legal and technical rules applicable to the hydrocarbons sector, promoting its sustainable development and technological improvement.

- **General Energy Environmental Matters Bureau ("GEEMB")**: The GEEMB proposes and/or issues the necessary legal-technical dispositions related to the conservation and protection of the environment in the hydrocarbon activities. Additionally, the GEEMB assesses and approves the environmental instruments required for hydrocarbons activities provided under a Semi Detailed Environmental Impact Assessment or an Environmental Impact Statement (See Section 3).
• **National Environmental Certification Service for Sustainable Investments ("SENACE"):** Created on December 2012, is the entity in charge of reviewing and approving detailed Environmental Impact Assessments (EIA-d), such for investment projects of national and multiregional scope involving activities, constructions, works and other commercial activities and services that are likely to cause significant environmental impacts. The implementation process of SENACE has been progressive and continuous, according to the schedule approved for this purpose. As of December 2015, SENACE has capacity over the energy (hydrocarbons and electricity) activities.

• **Supervising Agency of Investment in Energy and Mining ("OSINERGMIN"):** The OSINERGMIN is the independent regulatory agency that supervises and controls the activities of the hydrocarbon industry, ensuring that they are performed in accordance with the legal and technical safety provisions and standards. Also performs as tax authority regarding the supervising contribution to be paid by the hydrocarbons companies.

• **Environmental Assessment and Control Agency ("OEFA"):** OEFA governs the National System for Environmental Assessment and Control. It is responsible for verifying the compliance of environmental legislation and is entitled to evaluate, supervise, control, sanction and apply incentives in environmental matters. As well as the OSINERGMIN, OEFA performs as tax authority regarding the supervising contribution.

### 1.3 Relationship among the Government, NOC and IOCs

As previously mentioned, with the enactment of the Peruvian Constitution and the HOL, the Peruvian NOC, Petroperu, stepped out of the upstream. However, in 2016 Law N° 28840 - Law of strengthening and modernisation
of Petroperu, allowed the company to participate in every activity of the hydrocarbons value chain, nonetheless Legislative Decree N° 1292, limited its E&P activities to the previous existence of an agreement with an oil company and the prioritization of the Talara refinery modernisation. Another interesting feature of the existing regulations is that it does not restrict the participation in the upstream of foreign NOCs. Actually, Ecopetrol, CNPC, KNOC and Sonatrach have interests in producing blocks.

1.4 Upstream General Legal Framework

Oil and gas exploration and exploitation activities in Peru are governed by the Peruvian Constitution, the HOL, the Natural Gas Industry Promotion Law and a series of very detailed regulations covering, among other things, exploration, production, safety, and environmental matters.

The Peruvian Constitution establishes that all natural resources *in-situ*, including hydrocarbons, are owned by the Government.¹ The HOL provides that the Peruvian Government promotes the oil and gas exploration and/or production activities based on the principles of free competition and free access to the private sector, and sets forth the legal framework for the exploration and production of oil and gas.

Pursuant to the HOL, PERUPETRO is entitled to the extracted hydrocarbons for purposes of granting rights for their exploration and production on behalf of the Peruvian Government. The granting of these rights is performed through the execution of contracts that set the terms and conditions under which the exploration and production activities must be performed.

¹ The Peruvian Constitution adds that the conditions for its exploitation by private parties will be established by an Organic Law. Pursuant to its Article 106, the approval of an organic law requires the vote of the majority of the members of the Peruvian Congress. The same vote criteria shall be applied in the event of an amendment to an Organic Law.
The HOL regulates two kinds of contracts for performing exploration and production activities: (i) the License Agreement, in which PERUPETRO transfers the property of the extracted hydrocarbons to the licensee and then latter assumes the obligation of paying PERUPETRO an agreed royalty based on the produced hydrocarbons, and (ii) the Service Agreement, in which the property of the extracted hydrocarbons is not transferred to the contractor, who is only entitled to receive a compensation for the provided services, which is not contingent on the success of the activities.

Notwithstanding, pursuant to the HOL, oil companies can negotiate with PERUPETRO regarding other types of arrangements, provided they are authorized by the MEM.

In general terms, the main provisions of the HOL include the following:

- There are no restrictions for foreign oil companies, they are only required to operate through a subsidiary or branch domiciled in Peru.

- Producing oil companies can decide whether to trade their production locally or to export it.\(^2\)

- Oil and gas production is not determined by any governmental agency, the prices are freely established.

- Exportation of oil and gas is not subject to export taxes.

- Tax stability is granted for upstream activities.

- License Agreements for exploration and/or exploitation activities are protected by the Peruvian Constitution. Their terms and conditions cannot be unilaterally amended by PERUPETRO nor the

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\(^2\) The only exception is the natural gas produced from existing reserves on Block 88 that are mainly dedicated for the local market, as agreed in the corresponding License Agreement.
Peruvian Government without the prior agreement of the oil company.

- Any dispute arising from the performance of a License and/or Service Agreement is subject to the decision of an arbitration panel, in most of the cases to the ICSID.

- Ring-Fence is applicable for purpose of corporation tax (income tax).

In addition to the general legal framework, certain specific regulations had been approved in order to promote the development of a natural gas industry that did not exist in Peru prior to the year 2000 (See Section 1.5).

Finally, it should be noted that Peru has not yet approved special rules for the development of unconventional hydrocarbons. So far, potential of unconventional resources have only been reported at Block 31-E in the central jungle, operated by Maple Gas Corporation del Peru.

### 1.5 Promotion of the Natural Gas Industry

Prior to the development of natural gas reserves in Camisea, natural gas was not used in Peru. Although the fields in Block 88 were discovered in the 1980s, these reserves were not developed for a long time. The lack of natural gas demand was a hurdle to establishing the project to install a pipeline to transport gas from the central jungle to Lima, where there were greater chances of the gas being used.

To face this situation, the Peruvian Government passed the Law No. 27133, the Law for the Promotion of the Development of the Natural Gas Industry, and its regulations. This framework provided the incentives for developing the production of natural gas and the development of a local market. Among other dispositions, it established the following:
• Natural gas prices for the local market (from Block 88) were subject to price caps adjusted from time to time. The price for natural gas for power production was also limited to promote its industrial use.

• The operator of the natural gas transportation pipeline was provided with a guarantee of demand. This guarantee assured the required earnings for the operation and maintenance of the pipeline while the demand was being developed.

• The operator of the natural gas transportation pipeline was granted tax stability during the whole term of its agreement.

These conditions, in addition to those available in the HOL and others passed for promoting the development of liquefying natural gas (LNG) plants, had a positive impact, allowing a rapid development of the natural gas industry in Peru, with a growing local demand based on power generation, as well as on the exportation of LNG.

However, as this growth in demand surpassed all the forecasts, in the last 5 years, the capacity of the transportation system has had to be expanded to be able to meet the current needs, and the Government has been supporting a project to build a second pipeline. Moreover, in 2010 the Peruvian Government approved the Regulations for a Natural Gas Secondary Market (SPOT) to enable the transferring of gas production and of firm transportation capacity among gas distributors and independent consumers, however its implementation is on hold until the end of 2018.³

Lately, the Peruvian Government has been promoting the decentralized and massive use of natural gas. Law No. 29970 declares of national interest (i) the implementation of measures for the strengthening of the country’s

³ An electronic mechanism for auctions is expected to be implemented; meanwhile, transfers can be celebrated in the form of bilateral agreements.
energy security, and (ii) the production and transportation of ethane to the southern regions of Peru for the development of a Petrochemical Hub therein.

**Camisea Natural Gas**

In the case of the Camisea natural gas reserves, Block 88 and Block 56 have the main producing fields. The License Agreements were granted to a joint venture formed by Pluspetrol, Hunt Oil, SK Innovation, Tecpetrol, Sonatrach and Repsol. The designated operator for both blocks is Pluspetrol. In addition, Camisea basin also includes Block 57, which is operated by Repsol and has been producing natural gas since 2014, and Block 58, which is operated by CNPC, and in November 2016 reported proven reserves of 2.8 TCF.

For natural gas transportation, the Peruvian Government has in force two concession agreements. One for the transportation of natural gas from the Camisea gas fields to the Lima city gate, and the other for the transportation of gas-derived liquids from the Camisea gas fields to a fractionation plant in the central coast, where liquefied petroleum gas (LPG), naphtha and medium distillate for blending stock are being produced. Both concessions are operated by Transportadora de Gas del Peru S.A. In 2014 a concession agreement for the transportation of natural gas from the Camisea fields to the certain cities of the south of the country was granted to a joint venture formed by Odebrecht and Enagas, known as Gasoducto Sur Peruano, but it was later terminated in 2017.

Currently, the Peruvian government is preparing the launching of a new bidding process to grant concession for a transportation pipeline, with the same objective of providing natural gas to the southern cities of Peru, called “Sistema Integrado de Transporte de Gas Zona Sur del País”. The bidding process is expected to start in 2020. Also, the Peruvian government is seeking investors for a Petrochemical project to be based in the city of
Ilo, in order to make more attractive the development of the aforementioned pipeline.

In turn, for the distribution of the natural gas to independent and regulated customers, there are four pipeline networks under operation. The first one in importance is in the city of Lima and is operated by Gas Natural de Lima y Callao ("Calidda"), the second one is in the city of Ica and is operated by Contugas (both controlled by Colombian Grupo Energía de Bogotá). Also, since 2017 two more distribution concessions started operations in the country, one by Quavii (subsidiary of Colombian Promigas) in seven northern cities, another by Naturgy (subsidiary of the same named Spanish company, formerly Natural Gas Fenosa) in four southern cities. There is also two more awarded distribution concessions next to start operations in 2018, one in Piura city another in Tumbes city, where Gases del Norte (subsidiary of Promigas) and Peruvian Clean Energy are the owners, respectively.

To deal with the rapid growth of natural gas demand in the local market, the Peruvian Government has promoted the development of “virtual” transportation networks to benefit different cities in Peru. The concessionaires will transport liquefied natural gas (LNG) or compressed natural gas (CNG) from different supply points to the certain distribution pipeline networks. Indeed the distribution concessions of Quavii and Naturgy were conceived under such structure until they are able to connect to a transportation system.

Finally, the downstream segment includes a facility for LNG, which is supplied with natural gas from Blocks 56. This plant is operated by Peru LNG SRL and has been exporting LNG to Asia, North America and Europe since 2010. Since 2014 Shell performs as offtaker of the Peruvian LNG.
1.6 Oil Company Qualification

To carry out exploration and/or exploitation activities in Peru, the prospective oil companies need to first evidence to PERUPETRO that they comply with the technical, legal, economic and financial requirements and the experience necessary to engage in exploration and exploitation activities in a specific area. This process is called the “Qualification Procedure”.

The technical and financial requirements may vary from block to block, depending on the committed Minimum Work Program (MWP), and they will also depend on the percentage of participation the oil company will have as contractor and whether or not it will be the operator of the block.

In the case of a non-Peruvian company, the qualification as an oil company will be granted to its parent company or Corporation, which will be jointly liable for the legal, technical, economic, and financial capacity of its subsidiary or branch to be established and registered in Peru. The parent company must have been incorporated for at least two years. In addition, a national representative of Peruvian nationality must be appointed (“National Mandatory”).
When the contractor is comprised by more than one entity (consortium), an operator shall be appointed and can only be changed with the consent of PERUPETRO. Nevertheless, all contract holders are jointly responsible for all obligations under the agreement. Tax and accounting obligations are treated individually.

In 2017, PERUPETRO issued a set of policies, in order to attract investment granting easiness in the award of Contracts and Technical Evaluation Agreements so to cover last years’ negative gap of upstream activities in Peru.

In this regard the qualification requirements became more flexible than they previously was.

1.6.1 Indicators for Experienced Oil Companies

Legal Indicators

- Paperwork regarding the existence of the company and its ability to celebrate Contracts (as well as its representatives abilities for that).

Technical Indicators

- As general capabilities, the oil company must prove that it has at least 2 years of experience in executing exploration and/or exploitation activities within the last 3 years; or has been an non-operator in 3 contracts for 2 years, within the last 3 years.

- Alternatively, the oil company shall prove:

  (i) Having drilled 1 well (whether production or exploration) in 1 contract within the last 3 years, with a depth similar or higher than the minimal depth of the reservoirs of the required area; or
Having maintained during 2 of the last 3 years, in 1 or more contracts, an average production similar to the last 2 years average production of the requested block; or an average production of 1000 BOEPD.

- Is also required to prove having implemented an environmental management system within the last 3 years.

- To be an operator of a block, company’s capabilities shall be evaluated by PERUPETRO considering the 100% of the block’s estimated obligations, independent from its possible sharing in the Contract, whilst for a non-operators its capabilities shall be evaluated according to its possible sharing in the Contract.

- Different conditions from the abovementioned (whether higher or softer) may be approved by PERUPETRO, only for exceptional cases with the due evidence.

- Notwithstanding the aforementioned requirements, it is possible for a company to prove its Technical Capacity, only by means of being listed in the following publications: “The Energy Intelligence Top 100: Global NOC & IOC Rankings” or “The Platts Top 250 Global Energy Company Rankings”.

Financial Indicators:

- The *Minimum Capacity for Contracting* applicable for a certain block will be calculated by considering the value of the MWP for the block estimated by PERUPETRO.

- The actual capacity of contracting of the oil company will be subject to alternatively demonstrate one of the following capabilities:
(i) that 50% of Company’s 3 last years average residual equity is equivalent to the estimated MWP value;

(ii) to be a company listed in the following publications: “The Energy Intelligence Top 100: Global NOC & IOC Rankings” or “The Platts Top 250 Global Energy Company Rankings”.

(iii) present a favorable report of its financial solvency issued by a credit-rating agency authorized by the Peruvian securities market regulator; or

(iv) present a binding affidavit to create an escrow account up to Contract working program value.

1.6.2 Indicators for Non-Experienced Oil Companies

When companies do not have at least 2 years of experience in exploration or exploitation activities but have economic and financial capacity, they are required to associate with a technically qualified operator or to contract an experienced oil-field service company. The oil company will need to submit to PERUPETRO a letter of intent or memorandum of understanding for the association in the first case, or the contract itself in the latter.

1.7 Acquiring E&P Rights: License Agreement and Technical Evaluation Agreements.

As previously explained, the HOL foresees that upstream activities can be performed through two kinds of agreements, License Agreements or Service Agreements. The former is the most used in Peru and it is the one PERUPETRO was offering in the last bidding rounds.

The main features of the License Agreement are the following:

- According to Article 12 of the HOL, the License Agreement is a contract governed by private law and, therefore, cannot be
modified or terminated unilaterally by PERUPETRO nor the Peruvian Government without the agreement of the licensee.

- License Agreements normally have two phases: exploration and production. The exploration phase has a seven-year maximum term (under exceptional circumstances the term may be extended up to 3 additional years). License Agreements are granted for either a 30-year maximum term for crude oil or a 40-year maximum term for non-associated gas and condensates.

- The exploration periods are divided into several working periods. For each of them, the licensee will commit to perform a MWP that it will guarantee with a letter of credit.

- The licensee will be required from time to time to relinquish non-explored areas of the block unless further exploration is committed.

- Oil and gas produced can be marketed by the licensee locally or for exportation (except Block 88 which is required to supply the local demand subject to certain limitations).

- Oil and gas prices are established by the producers (except Block 88, where the price for the local market is subject to price caps).

- Royalties are considered as a cost.

- Disputes under the license agreements will be decided on an arbitration process, in most of the cases to the ICSID.

- Benefits granted in the license agreements:
  
  (a) Stability of the tax regime in force at the time of execution of the agreement.
(b) Access to free currency exchange and stability of the currency exchange regime in force at the time of execution of the agreement, including the right to repatriate its investments and profits.

(c) Possibility of amortizing the exploration and development expenses in 5 years.

(d) Export of hydrocarbons is exempt from all taxes.

(e) Import of assets required for exploration activities are exempt from all taxes.

(f) Temporary import of goods for a period of 2 years.

(g) Possibility of keeping its accounting in American dollars.

(h) Early recovery of the VAT paid during the exploration phase.

A License Agreement can be granted through direct negotiations with PERUPETRO, through bidding rounds or by acquiring an existing License Agreement. The agreements’ terms and the block delimitation are approved by a Supreme Decree, signed by the President of Peru and endorsed by the MEM and the Ministry of Economy and Finance prior to their celebration. The License Agreement can only be signed with such prior approval. This procedure is also followed every time the agreement is amended or assigned.

Figure 2: Approval Procedure of License Agreement

Maximum Term: 60 Calendar Days
It is also possible for an oil company to acquire exploration rights by means of a Technical Evaluation Agreement (TEA), which is an option to begin exploration activities with low requirements and commitments then to enter into a License Contract with PERUPETRO. Some highlights of these type of agreements are:

- There are two types of TEA’s:
  
  (i) TEA: Over “Frontier” areas (such with few geological knowledge) whose duration is 24 months; and

  (ii) TEA – Contract: Over “Semi-Explored” Areas (such with some geological information but not enough, besides access and transportation difficulties) whose duration is 24 months, extensible to 12 additional months. Includes an intention to sign a Contract at the end of its term.

- If the area of interest of the company is not under negotiation nor bidding process by PERUPETRO, is possible for the company to apply for a direct negotiation process, where to start is enough to certify superior technical capacity (under certain guidelines) or to be a company listed in the following publications: “The Energy Intelligence Top 100: Global NOC & IOC Rankings” or “The Platts Top 250 Global Energy Company Rankings”.

- Unlike License Contracts, is not mandatory to constitute a local branch to sign a TEA, so the foreign company could enter directly into the agreement.

- It is possible to amend a TEA as a result of a farm in (whether total or partial), subject to the previous approval of PERUPETRO. This allows the companies to incorporate a partner in the project or to transfer it.
During its term, TEA gives to the company a right of first option to sign a License Contract with PERUPETRO.

2. General Tax Regime for Upstream Activities

The HOL has established a special tax regime for upstream activities, which includes – among other things – tax stability and special treatment for investment on blocks.

Tax Stability: The HOL guarantees a “Tax Stability Regime” to the contractors that implies that the tax regime applicable to the contract shall be the one in force by the time the latter was celebrated. Thus, taxes established or created later, or changes in tax law which become effective later, will not be applicable to the contract’s activities.

Income Tax (IT) - Contractors carrying out oil and gas exploration or exploitation activities in more than one contract area, and who also carry out other related activities, should determine every year’s results separately for each contract area and each activity in order to calculate their IT.

The Tax Stability Regime described above only covers the following activities that can be performed within a contract:

- Contract activities: Activities that derive directly from the contract execution, such as exploration or exploitation activities.

- Complementary activities: Activities that need to be executed under the contract, but that do not generate additional revenue to the contractor.

Complementary activities that generate additional revenue to the contractor, related activities (activities executed by contractor but are not within the execution of the contract) and any other activities are not subject to the Tax Stability Regime.
Compensation of losses is only allowed between contract activities (including complementary activities) and related activities, even when they correspond to different contracts.

Exploration and development costs, as well as investments made in a contract area in which the exploitation phase is still to be reached, shall be accumulated in a separate account, the amount of which shall be amortized following one of the methods or procedures given below:

- By production unit; or
- By linear amortization, deducting them in equal parts, during a period of at least 5 fiscal years.

The corporate IT rate for entities domiciled in Peru for Peruvian tax purposes is currently 29.5%. An additional 2% shall be applicable to contracts to enjoy the Tax Stability Regime. However, depending on the activities to be performed and the type of product subject to such activities, the contractor may be exempt from said 2% additional tax.

Value Added Tax (VAT) - The current rate for VAT is 16%. Jointly with the VAT the Promotional Municipal Tax (PMT), whose rate is 2%, is applicable. Hence a total rate of 18% coming from VAT and PMT, applies for certain sales and purchases of goods and services. VAT and PMT shall not be determined by each contract or activity as IT, but rather on every transaction (levied) carried out by the contractor, regardless of the contract or activity which said transactions derive from or are related to.

There is a special benefit for oil and gas investment which consists of obtaining a refund of the VAT and PMT that the contractor has paid on its acquisitions of goods or services directly related to the contract activities. Currently, there are two VAT and PMT refund regimes in force: the “definitive refund” and the “early refund” regime.
Imports and exports - The contractor is able to import goods which may be necessary to carry out exploration activities free of any tax. Said goods should only be used in those activities; otherwise, the contractor shall pay all the import taxes.

Additionally, the export of oil and gas is free from any tax under the HOL.

Accounting rules - Contractors that hold more than one contract, or perform related or other activities, shall prepare independent financial statements for each contract and activity, regardless of whether or not they are obliged to prepare consolidated financial statements.

The Accounting Procedures Manual applicable to each contract should establish the mechanisms to allocate the income, expenses, amortizable expenditures and investments on each contract or each one of the related activities.

3. The Midstream and Downstream

The transportation, distribution and trading of hydrocarbons are free, subject to the regulations approved by the MEM and OSINERGMIN (e.g., be registered at the Hydrocarbons Registry as a storage plant, wholesale distributor, importer in transit, retailer, direct consumer, gas station, etc.). There is no restriction for the participation of foreign companies in those activities.

As already noted in Section 1.5., the use of pipelines for the provision of transportation and distribution services (both considered “public services” in the case of natural gas) requires the granting of a concession agreement by the MEM. The transport and distribution tariffs are regulated by the concession agreement itself and the rules approved by OSINERGMIN.

In turn, the Law on the Promotion of Investment in Petrochemical Plants provides legal and tax benefits that encourage investment in the construction and operation of petrochemical plants located in
decentralized areas designated by the MEM. Currently, there are four of these designated areas: “San Juan de Marcona” and “Paracas” in the Ica region, “Lomas de Tarpuy, Contayani, San Andrés y Quebrada Verde” in Arequipa, and “Lomas de Ilo” in the region of Moquegua.

In the same line, the Peruvian Government has passed the Law 29690, which promotes the development of the Petrochemical Industry based on ethane and the energy node in southern Peru. This law declares of public necessity and national interest the promotion and development of the petrochemical industry based on the ethane content in natural gas, prioritizing that which would be installed in the south of Peru, and in turn, promotes the decentralized development of pipeline-based transportation systems for hydrocarbons. Nowadays the energy node is working with its two projected thermoelectric power plants, one operated by Engie (720 MW) in Moquegua another by Samay (788.8 MW) in Arequipa. Both plants are currently powered by Diesel B5 until a natural gas supply could reach their facilities (the transportation pipeline “Sistema Integrado de Transporte de Gas Zona Sur del País” is supposed to supply this plants when it enters in operation).

4. Fuel Price Stabilization Fund

In 2004, the Peruvian Government adopted the first economic measures to address the volatility regarding the international prices of fuels and to mitigate effects on the domestic economy. At the beginning, the Government tried to do it by reducing the Excise Tax (“Impuesto Selectivo al Consumo”) for each fuel, but then it opted for the creation of a Fuel-Price Stabilization Fund (“Fondo de Estabilización de los Precios de los Combustibles” or “FEPC”) by means of Urgency Decree N° 010-2004, and decided to keep it as a permanent measure since 2013 by Law N° 29952.

The patrimony of the FEPC is formed by the additions and discounts that importers and producers make to the prices of the “Products” in their Primary Sales, depending on whether the Import Parity Price (“IPP”) or the
Export Parity Price ("EPP") of the fuels, as applicable, is above or below a certain price-band approved and updated bimonthly by OSINERGMIN.

The FEPC is managed by the GHB and the funds in it are intangible, non-seizable, non-transferable, and not considered public resources, in this regard they are kept in a trust.

Additionally, it should be noted that the transfer of public funds into the FEPC is authorized by the Ministry of Economy and Finance from time to time in case the FEPC lacks funds to pay the compensations owed to the producers and importers. This is intended to provide credibility to the scheme, security to the agents and discipline to the authority.

The incentive offered by the Government to the importers and producers of fuels participating in the FEPC is the promise that, over time, they will not suffer any economic loss by establishing their prices within the Price-Band. While the parity prices are below the lower limit of the band, the agents will make contributions to the FEPC which will then be used to compensate them when the parity prices exceed the upper level of the band. If there are no resources in the FEPC, the Peruvian Government commits itself to provide the necessary funds.
Indeed, as a rule, the FEPC will compensate the Producer/Importer with a quantity equal to the Compensation Factor for each Primary Sale in consideration of the discount the Producer/Importer makes to its sale price to keep it within the Price-Band. At the same time, the FEPC receives an amount from the Producer/Importer as Contribution Factor for each Primary Sale with the understanding that the agent adds such Contribution Factor to its sale price.

To date, the “Products” within the scope of the FEPC are the following:

**Industrial Fuels (N°6)**  * Provided they are used in power generation activities in isolated systems.

**LPG**  * Only for its cylinder presentation.

**Diesel BS**  * Provided it is destined for:
  (a) vehicular use (i) sold through Establishments for the Sale of Fuels to the Public or (ii) bought by Direct Consumers duly registered in the Hydrocarbons Registry, which carry out transportation activities as authorized by the Ministry of Transports and Communication; or
  (b) power generation in isolated systems.
5. Environmental, Social and Archaeological Regulations

5.1 Environmental Certification

According to the National Environmental Impact Assessment Law, Law No. 27446, and its Regulation, approved by Supreme Decree No. 019-2009-MINAM, any legal entity which intends to develop hydrocarbon activities that may generate environmental impacts must previously obtain the approval of an environmental certificate. This environmental certificate is a ruling to be issued by the pertinent environmental authority which approves an environmental management instrument. That is to say, the environmental certificate is a statement by the pertinent authority that a project is feasible on environmental terms.

The hydrocarbon activities subject to an environmental certificate are contained in the List of Investment Projects subject to the National Environmental Impact Assessment System (“SEIA”) included in Exhibit II of the above-mentioned Regulations, as amended from time to time. Based on the environmental impacts that may arise, all projects must be classified into the following categories:

1. Projects that generate minor adverse environmental impacts to the environment are required to have an Environmental Impact Statement (“DIA”).

2. Projects which are expected to cause moderate adverse environmental impacts are required to have a Semi Detailed Environmental Impact Assessment (“EIA-SD”).

3. Projects which are expected to cause significant adverse environmental impacts, a Detailed Environmental Impact Assessment (“EIA”) is required.

As may be observed, each category refers to a different instrument for environmental management, by virtue of the environmental impact caused
by the investment project to the environment. Environmental studies must be prepared by a registered environmental consulting firm in the Registry held by SENACE.

In the case of oil and gas activities, the Hydrocarbons Environmental Regulations approved by Supreme Decree N° 039-2014-EM, establish the main environmental rules applicable to the hydrocarbon activities.

According to these regulations, the oil companies are environmentally liable for their effluents, emissions, noise, and solid wastes produced in the operation of their facilities.

The Environmental Hydrocarbons Regulations establish that the approval of the following environmental instruments is required to perform the upstream activities specified in the charts below.

<table>
<thead>
<tr>
<th>Geographical Scope</th>
<th>Classification</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Offshore</td>
<td>EIA-SD</td>
<td>When the 2D or 3D exploration project is within one or more of the following areas or maritime ecosystems:</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Natural Protected Areas, including their Buffer Zones.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Fragile Ecosystems (bays, points and islands) or critic habitats which are important for the reproduction and growth of endemic or threatened species or of economic importance.</td>
</tr>
</tbody>
</table>
### Seismic Exploration

<table>
<thead>
<tr>
<th>Geographical Scope</th>
<th>Classification</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>•</strong> Natural bank areas of benthonic resources, reefs or for egg-laying located within the area of influence of the project or in relation with certain endemic and/or threatened species.</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>•</strong> The seismic lines will be registered within 5 miles from the coastline.</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>DIA</strong></td>
<td>Other projects, unless otherwise determined by the Environmental Authority.</td>
<td></td>
</tr>
<tr>
<td><strong>Coast</strong></td>
<td><strong>EIA-SD</strong></td>
<td>When the 2D or 3D exploration project is within one or more of the following areas or inland ecosystems:</td>
</tr>
<tr>
<td></td>
<td></td>
<td><strong>•</strong> Natural Protected Areas, including their Buffer Zones, or Regional Conservation Areas.</td>
</tr>
<tr>
<td></td>
<td></td>
<td><strong>•</strong> Fragile Ecosystems (dunes, oasis, hills, wetlands, relict forests, dry forests, bays and points, Ramsar sites) or critic habitats which are important for the reproduction and growth of endemic or</td>
</tr>
<tr>
<td>Geographical Scope</td>
<td>Classification</td>
<td>Description</td>
</tr>
<tr>
<td>--------------------</td>
<td>----------------</td>
<td>-------------</td>
</tr>
<tr>
<td></td>
<td></td>
<td>threatened species.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Projects that imply the construction of new roads.</td>
</tr>
<tr>
<td></td>
<td>DIA</td>
<td>Other projects, unless otherwise determined by the Environmental Authority.</td>
</tr>
<tr>
<td>Highlands</td>
<td>EIA-SD</td>
<td>When the 2D or 3D exploration project is within one or more of the following areas or inland ecosystems:</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Natural Protected Areas, including their Buffer Zones, or Regional Conservation Areas.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Fragile Ecosystems (Quenoal areas, wetlands, Ramsar sites, inter-Andean valleys, lakes, high-Andean lagoons, fog forests or relict forests) or critic habitats which are important for the reproduction and growth of endemic or threatened species.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Projects that imply the construction of new roads.</td>
</tr>
<tr>
<td></td>
<td>DIA</td>
<td>Other projects, unless otherwise determined by the Environmental Authority.</td>
</tr>
</tbody>
</table>
# Seismic Exploration

<table>
<thead>
<tr>
<th>Geographical Scope</th>
<th>Classification</th>
<th>Description</th>
</tr>
</thead>
</table>
| Authority.         | EIA-d          | When the 2D or 3D exploration project is within one or more of the following areas or inland ecosystems:  
- Natural Protected Areas, including their Buffer Zones, or Regional Conservation Areas.  
- Fragile Ecosystems (wetlands, Ramsar sites, inter-Andean valleys, lakes, marsh, swamps) or critic habitats which are important for the reproduction and growth of endemic or threatened species.  
- Territorial reserves or indigenous reserves.  
- Areas with not previously disturbed/affected habitats.  
- Projects that imply the construction of new accesses (tracks and roads). |
| EVAP               | Other projects, for the Environmental Authority to establish the applicable classification. |
### Exploratory Drilling

<table>
<thead>
<tr>
<th>Geographical Scope</th>
<th>Classification</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Offshore</td>
<td>EIA-d</td>
<td>EIA-d will apply to projects located within one or more of the following areas or ecosystems:</td>
</tr>
<tr>
<td></td>
<td>or EIA-SD</td>
<td>• Natural Protected Areas, including their Buffer Zone.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Fragile ecosystems (bays, points and islands) or critical habitat important for the reproduction and growth of endemic or threatened species.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Areas of natural banks of benthic resources, reefs or egg-laying areas located within the area of influence of the project or in relation with certain endemic and/or threatened species.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Maritime Areas within 5 miles from the coastline.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• The area of study comprises the drilling of more than 5 potential wells or mooring points or involves at least one fixed platform.</td>
</tr>
</tbody>
</table>

However, Oil Companies can elaborate and present a Preliminary Environmental Evaluation (PEE) for
the Environmental Authority to establish the applicable classification when the project does not match the abovementioned criteria or when the project has particular conditions that might support a different category.

<table>
<thead>
<tr>
<th>Geographical Scope</th>
<th>Classification</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Coast and Highlands</td>
<td>EIA-d or EIA-SD</td>
<td>EIA-d will apply to projects located within one or more of the following areas or ecosystems:</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Natural Protected Areas, including their Buffer Zone, or Areas of Regional Conservation.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Fragile ecosystems (dunes, oasis, hills, wetlands, dry forests, bays, points, Ramsar sites, quenoales areas, inter-Andean valleys, lakes, high-Andean lagoons, fog forests or relict forests) or critic habitat important for the reproduction and growth of endemic or threatened species.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Projects including the construction of new roads.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• The area of study comprises the drilling of more than 5</td>
</tr>
<tr>
<td><strong>Geographical Scope</strong></td>
<td><strong>Classification</strong></td>
<td><strong>Description</strong></td>
</tr>
<tr>
<td>------------------------</td>
<td>-------------------</td>
<td>-----------------</td>
</tr>
<tr>
<td>Rainforest</td>
<td>EIA-d</td>
<td>For all projects of exploratory drilling. However, Oil Companies can elaborate and present a Preliminary Environmental Evaluation (PEE) for the Environmental Authority to establish a different classification when the project has particular conditions that might support a different category.</td>
</tr>
</tbody>
</table>

However, Oil Companies can elaborate and present a Preliminary Environmental Evaluation (PEE) for the Environmental Authority to establish the applicable classification when the project does not match the above mentioned criteria or when the project has particular conditions that might support a different category.
### Exploitation

<table>
<thead>
<tr>
<th>Geographical Scope</th>
<th>Classification</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Offshore</td>
<td>EIA-d</td>
<td>Fall of the projects of development and production, including those foreseeing hydraulic fracturing (fracking).</td>
</tr>
<tr>
<td>Coast</td>
<td>EIA-d</td>
<td></td>
</tr>
<tr>
<td>Highlands</td>
<td>EIA-d</td>
<td></td>
</tr>
<tr>
<td>Rainforest</td>
<td>EIA-d</td>
<td></td>
</tr>
</tbody>
</table>

### Pipeline Transportation

<table>
<thead>
<tr>
<th>Geographical Scope</th>
<th>Classification</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Coast</td>
<td>EIA-d</td>
<td>For all projects of pipeline transportation. However, Oil Companies can elaborate and present a Preliminary Environmental Evaluation (PEE) for the Environmental Authority to establish a different classification when the project has particular conditions that might support a different category. The PEE shall consider the features of the area, the length and diameter of the pipes, the transportation systems and accessories (main pipelines, own use pipelines, and pipelines for recollection and injection).</td>
</tr>
<tr>
<td>Highlands</td>
<td>EIA-d</td>
<td></td>
</tr>
<tr>
<td>Rainforest</td>
<td>EIA-d</td>
<td></td>
</tr>
</tbody>
</table>
### Pipeline Distribution

<table>
<thead>
<tr>
<th>Activity</th>
<th>Classification</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pipeline Distribution</td>
<td>EIA-SD</td>
<td>Gas trunklines or high pressure lines</td>
</tr>
<tr>
<td></td>
<td>DIA</td>
<td>Distribution Projects in Urban Areas (Low Pressure Distribution Networks, supply connections) have to include the corresponding Contingency Plan and comply with the applicable safety and urban rules.</td>
</tr>
</tbody>
</table>

### Processing or Refinery

<table>
<thead>
<tr>
<th>Geographical Scope</th>
<th>Classification</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Coast</td>
<td>EIA-d</td>
<td>For all the projects of processing or refinery.</td>
</tr>
<tr>
<td>Highlands</td>
<td>EIA-d</td>
<td></td>
</tr>
<tr>
<td>Rainforest</td>
<td>EIA-d</td>
<td></td>
</tr>
</tbody>
</table>

### Commercialization

<table>
<thead>
<tr>
<th>Type of Establishment</th>
<th>Classification</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Liquid Fuels</td>
<td>DIA</td>
<td>The sale establishment that commercializes one or more of these products has to submit only</td>
</tr>
<tr>
<td>Gas Centers (LPG for car use)</td>
<td>DIA</td>
<td></td>
</tr>
</tbody>
</table>
### Commercialization

<table>
<thead>
<tr>
<th>Type of Establishment</th>
<th>Classification</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Vehicle Natural Gas Stations (VNG)</td>
<td>DIA</td>
<td>one DIA, specifying the information corresponding to each of the products.</td>
</tr>
<tr>
<td>Compressed Natural Gas Stations (CNG)</td>
<td>DIA</td>
<td></td>
</tr>
<tr>
<td>Bottling Plants</td>
<td>DIA</td>
<td></td>
</tr>
</tbody>
</table>

In addition, the oil company must file an Annual Environmental Report with the GEEMB before March 31 every year providing detailed information concerning the compliance of environmental regulations.

Finally, in order to terminate any hydrocarbons activity, the oil company shall present an Abandonment Plan (Decommissioning Plan). The Abandonment Plan will contain detailed and scheduled measures such as clean up, remediation, reforestation, dismantlement of facilities, etc. Besides, the oil company must provide a letter of credit guaranteeing up to 75% of the total amount of the Abandonment Plan costs.

In Peru, the entity in charge of evaluating the environmental aspects of hydrocarbon projects are the Ministry of Energy and Mines, SENACE or the Regional Governments depending on the activities to be performed. However, the environmental supervision and law enforcement of hydrocarbons activities are carried out by OEFA.

### 5.2 Natural Protected Areas

Natural Protected Areas (NPAs) are areas considered of high environmental and biodiversity relevance and, for such reasons, they require the
government’s protection. NPAs are patrimony of the nation and of public domain. A NPA has to be expressly recognized and declared as such by the Servicio Nacional de Áreas Naturales Protegidas (SERNANP) and its natural condition shall be maintained for perpetuity.

The NPAs Law, Law No. 26834, classifies NPAs as follows: (i) NPAs of national administration; (ii) NPAs of regional administration or Regional Conservation Areas; and (iii) Private Conservation Areas.

The use of non-renewable natural resources, such as oil and gas, within NPAs is restricted. Oil and gas activities can only be authorized within NPAs if such activities are considered in the Master Plan of the NPAs and if they fulfil the environmental standards, limitations and restrictions applicable to these protected areas.

Any activity within an NPA shall be authorized by SERNANP. The applicable law acknowledges any pre-existing rights to the creation of the relevant NPA. However, these rights shall be exercised in harmony with the goals and purposes for which the NPA was created.

### 5.3 Prior Consultation Law

Peru has ratified ILO Convention No. 169, regarding Indigenous and Tribal Peoples in Independent Countries, through Legislative Decree No. 26253 and its regulations. This treaty has been implemented by the Prior Consultation Right Law, passed by Congress on 2011. This Law acknowledges indigenous and tribal peoples’ consultation rights, because their collective rights may be affected directly by a legislative or administrative measure. However, it is a consultation right, but not a veto.

In the case of upstream activities, prior consultation by PERUPETRO will be necessary prior to the granting of the license agreement for the exploration and exploitation of oil and gas in areas in which indigenous or native communities are located. PERUPETRO has implemented prior consultation processes in more than ten blocks.
It is important to note that the Peruvian Government has approved an Official Database of the Indigenous People⁴, which identifies the indigenous people that have the right to the prior consultation. However, it should be noted that such Official Database is only referential.

Finally, it is important to note that the regulation of the referred Law establishes that any project that fits as a “public service” project (such as a gas transportation or distribution project) will not be subject to the prior consultation procedure, but will necessitate performing “prior coordination actions” with the appropriate indigenous people provided that such “public service” project benefits such indigenous people.

5.4 Protection of Cultural and Archaeological Heritage

The legal framework applicable to cultural and archaeological heritage establishes that any evidence of archaeological remains, independent of their location and whether or not they have been discovered or identified, is protected by law. In that sense, any project that intends to remove any topsoil requires the previous obtainment of a Certificate of Non-existence of Archaeological Remains (“CIRA”) from the Ministry of Culture.

The CIRA will either certify that no archaeological sites or remains were discovered, or will identify their exact location and extension in order to implement precautionary measures. The CIRA is valid for an unlimited period, but will become void should any archaeological remains be discovered during the construction works or due to any other reason. Further, project developers are required to obtain an Archaeological Monitoring Plan (PMA) from the Ministry of Culture in order to prevent, avoid, control, reduce or mitigate possible negative impacts on or before the work execution phase.

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⁴ http://bdpi.cultura.gob.pe/
The Ministry of Culture is authorized to order the suspension or demolition of unauthorized works, or of those works the execution of which is contrary, modifies or ignores the technical specifications and directly or indirectly affects the structure or harmony of properties related to the National Cultural Heritage, requesting the assistance of the police force, if necessary.

6. Safety Regulations

In Peru, OSINERGMIN has the role of monitoring and supervising oil and gas companies as well as enforcing safety standards by applying penalties as a deterrence measure for infringements of safety compliance.

The main safety instruments required for companies performing oil and gas activities are described below.

Contingency Plan

This plan must be elaborated and subscribed by a professional dully accredited before the Experts Registry that manages OSINERGMIN, and it has to contain the measures to be undertaken in the event of spills, leaks, explosions, accidents, fires, evacuations, natural disasters or the presence of populations in isolation or in initial contact situations. It shall also describe the procedures, human resources, equipment and materials aimed to prevent, control and rehabilitate the areas affected by leaks and spills of hydrocarbons or chemical products. OSINERGMIN is authorized to paralyse the hydrocarbons activities should the Contingency Plan be inadequately implemented.

Risk Assessment

A risk assessment covers the safety aspects of the hydrocarbons installations and its area of influence, with the purpose of preventing some effects and consequences of the installation and operation. It indicates the proceedings, measures, and control measures that will need to be applied
to eliminate the eventual unsafe conditions and actions. This assessment must be elaborated and subscribed by a professional dully accredited before the Experts Registry that manages OSINERGMIN.

[Revised as of July 2018]
Venezuela

Venezuela Upstream Industry

1. Industry Background

The oil policy is based upon the consideration that certain oil activities and related works can only be performed by either wholly-owned State entities or mixed companies (*empresa mixta*), in which only a limited private participation is allowed under the 2001 Organic Law of Hydrocarbons (“OLH”), as amended by law reprinted in the Official Gazette Nº 38.493 on August 4, 2006.

The OLH is intended to regulate all hydrocarbon-related activities, for which it differentiates four types of activities: (i) primary, (ii) refining of natural hydrocarbons, (iii) industrialization of refined hydrocarbons; and (iv) marketing.

Primary activities include the exploration for natural hydrocarbon reservoirs, the extraction of hydrocarbons in their natural state as well as their initial collection, transportation and storage, as well as the works necessary for such activities.

The *empresa mixta* system established by the OLH with respect to oil activities reserves some activities and eliminates the preexisting reserve of other activities. Private participation and investment are allowed in carrying out primary activities with State participation and control, if the National Assembly has approved the terms and conditions under which the activities will be conducted. The National Assembly maintains the power to modify the proposed terms and conditions or establish the new ones at its convenience.
No private operators are allowed and title to production corresponds to the holder of the right to conduct primary activities, namely either a State-owned entity or an empresa mixta.

Usually the empresa mixta is a Venezuelan compañía anónima, domiciled in Venezuela and subject to Venezuelan law. The Venezuelan State must hold more than 50% of the capital stock of the empresa mixta, commonly 60%, and must keep control of operations and corporate decisions.

Private entities may provide services to the oil industry, but also in this area certain limitations apply pursuant to the Organic Law Reserving to the State the Goods and Services related to Primary Hydrocarbon Activities (“OLR”), published in the Official Gazette N° 39.173 on May 7, 2009.

2. **Legal Framework**

As mentioned above, the general framework of the oil industry is established in the OLH. The OLH was enacted pursuant to Article 302 of the Constitution, which allows the reservation of oil activities to the State.

The direction of oil policy and operations has been entrusted to Petróleos de Venezuela, S.A. (“PDVSA”), which serves as the holding company for the Venezuelan oil industry. The shares of the capital stock of PDVSA cannot be privatized (Article 303 of the Constitution).

Private participation in primary oil activities requires several presidential and parliamentary approvals. Private participation and investment are allowed in carrying out primary activities with State participation and control, if the National Assembly has approved the terms and conditions under which the activities will be conducted. The National Assembly maintains the power to modify the proposed terms and conditions or establish the new ones at its convenience.
The definition of oil projects is made by PDVSA. However, private participants may propose to PDVSA the development of specific projects subject in any case to the corresponding approvals.

Recently, the President of the Republic issued Decree 44 of 12 April 2018, regulating the transitory regime of the national oil industry (“Decree 44”). According to Decree 44 the Ministry of Petroleum has the powers to create or modify State-owned companies in the oil sector including PDVSA and its subsidiaries.

3. **Major Industry Players**

PDVSA is Venezuela’s national oil company. It was created in 1975 by the Oil Nationalization Law. It functions as a holding company, and has a wide network of affiliates and subsidiaries, both domestically and abroad.

There is a tight control exercised by the National Executive over PDVSA’s activities. Over the years, PDVSA has expanded very much, and nowadays its functions go well beyond the oil sector and it has divested from a number of oil businesses abroad.

For instance, on February 2016, the government created the “*Compañía Anónima Militar de Industrias Mineras, Petrolíferas y de Gas*” (CAMIMPEG), a wholly-owned State company ascribed to the Ministry of Defense. The main purposes of the company in oil related activities seem to be providing services other than the exploration and exploitation of oil.

Traditional major players in the oil business are active in Venezuela. Notoriously absent from Venezuela are ExxonMobil and ConocoPhilipps. More recently, newcomers from Vietnam, Iran, Peru, Russia, China, etc., are looking for a place in the business.
3.1 Relationship among the Government, NOC and IOCs

Generally, IOCs and NOCs are allowed to execute the granting instruments. Their role is not limited to providing services to the local NOC or any other State entity. The Ministry of Petroleum (MP) is the authority in charge with the granting of E&P rights.

Regarding upstream activities, IOCs and NOCs are selected by PDVSA and the MP in order to act as minority shareholders of the *empresa mixta* which will be the holder of the E&P rights.

Usually, the IOCs or NOCs will be shareholders of the *empresa mixta* together with a wholly-owned State entity, which latter entity will act as the majority shareholder.

4. Acquiring E&P Rights

4.1 Licensing Rounds

Under current State policy, the granting of exploration and exploitation rights is usually made by the President of the Republic by way of direct adjudication.

Participants from friendly States will be preferred. In some instances, public bidding is the selection mechanism. Foreign companies are welcome to participate in similar terms as any other domestic entities. Generally, the association between foreign and domestic companies will be considered a plus, but it is not decisive. The main driver is whether the foreign company is a NOC or comes from a politically friendly country.

<table>
<thead>
<tr>
<th>Judgement Criteria</th>
<th>Minimum and Maximum</th>
<th>Weight</th>
</tr>
</thead>
<tbody>
<tr>
<td>Political</td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>
4.2 Granting Instruments

Usually, the granting instrument is a complex act composed of several specific governmental acts. First, the National Assembly must authorize the creation of the *empresa mixta* as well as any and all association conditions of the specific project. The President of the Republic will order the creation of the relevant *empresa mixta*, and subsequently will issue a Decree transferring the right to conduct the primary activities to the *empresa mixta*.

The granting instrument confers upon its holder the rights to perform primary hydrocarbon activities (mainly exploration and exploitation).

The *empresa mixta* will be created for a maximum 25-year term, plus an extension up to 15-years. The authorization will also establish the minimum work program commitment and other special advantages in favour of the State, particularly in respect of government takes. All oil produced will be owned by the *empresa mixta*, and must be sold to PDVSA only.

Usually the granting instrument stipulates that the direct or indirect transfer of any interest in an *empresa mixta* is subject to the prior written consent of the MP. In addition, Decree 44 sets forth that the MP has the power to modify State-owned companies in the oil sector including PDVSA and its subsidiaries. However, any change of the original terms of the *empresa mixta* will require the authorization of the National Assembly.

Unitization provisions are seldom included in granting instruments. However, unitization is regulated in the OLH and in international treaties (i.e., Trinidad and Tobago). All assets and facilities related to exploration and exploitation activities are subject to reversion. In this case, title to the assets and facilities is transferred to the Republic free of liens and without any indemnification.

*Empresa mixtas* are bound to secure the continuity and non-interruption of the performance of primary activities.
As a matter of public policy, disputes related to the *empresa mixta* or the granting instrument will be subject to Venezuelan courts and to Venezuelan laws.

5. **Government Takes**

Article 44 of the OLH provides that the State is entitled to receive a royalty equivalent to 30% of the hydrocarbons volume extracted from any reservoir. The National Executive may reduce this royalty to (i) 20% for extra-heavy crude oil projects in the Orinoco Oil Belt and the exploitation of mature oil fields; and (ii) 16 2/3% for projects for the extraction of bitumen mixtures in the Orinoco Belt. These reductions are for the purpose of guaranteeing the economic viability of the projects. Although the OLH does not contain any provision that expressly allows the reduction of royalty payments in other cases, it appears such a reduction is legally possible since the National Executive is authorized to demand only a portion of the royalty due by the licensee. The royalty may be paid to the State both in cash and in kind.

In addition to the royalty, the OLH establishes the following taxes:

An Extraction Tax, which represents one-third of the value of all liquid hydrocarbons extracted from any reservoir. The operating company that extracts said hydrocarbons will pay this tax on a monthly basis, together with the royalty set forth in Article 44. To calculate this tax, the taxpayer is entitled to deduct what it has paid as royalty, including the additional royalty it pays as special advantage (3.3%, as provided by the Agreements for the organization of mixed companies approved by the National Assembly). Also, the taxpayer is entitled to deduct from this tax the amounts he has paid for any annual special advantage, but only in periods subsequent to those in which said special annual advantages have been paid. The Executive Branch, in order to encourage certain activities of public or general interest, may reduce this tax to 20% for the period of time it determines is necessary or until causes for exoneration have ceased.
A Surface Tax equivalent to 100 tax units per square kilometer, or a fraction of the area granted that is not exploited each year, to be increased by 2 percent annually for the first five years and by 5 percent annually in the following years.

An Export Registration Tax, provides for a 0.1 percent tax of the value of all hydrocarbons exported from any port in the national territory. The tax will be calculated using the sales price of said hydrocarbons. To this end, the seller is required to report the volume, API grade, sulfur contents and destination of the shipment to the MP before the ship leaves port. Within 45 calendar days following the date of departure, the seller will submit a copy of the relevant invoice and proof of insurance payment to the MP.

Furthermore, operations related to the international exportation for the purpose of selling liquid hydrocarbons (natural or improved) and some byproducts thereof shall be subject to a special contribution (the “Contribution”), created by the law that establishes the Special Contribution based on Extraordinary and Exorbitant Prices in the International Hydrocarbons Market (the “Law”), published in the Special Official Gazette No. 6.022 of 18 April 2011, on which date it became effective. It was more recently amended by the National Assembly as published in the Official Gazette No. 40.114 of 20 February 2013. The obligation to pay the Contribution remains with the exporter of liquid hydrocarbons or byproducts for the purpose of selling them abroad, including mixed companies that sell such products to PDVSA or any of its subsidiaries.

Regarding the Extraordinary Prices, the Contribution due by the taxpayers is the result of applying the 20 percent rate to the difference between the price established in the Annual Budget Law for each fiscal year and the price of the average monthly international quotation of the Venezuelan liquid hydrocarbons basket when it is equal to or lower than US$80.
With respect to the Exorbitant Prices, the Contribution due by taxpayers is the result of applying:

1. a rate of 80 percent to the difference between both prices, when the exorbitant prices are higher than US$80 per barrel but lower than US$100 per barrel;

2. a rate of 90 percent to the difference between both prices, when the exorbitant prices are equal to or higher than US$100 per barrel but lower than US$110 per barrel; and

3. a rate of 95 percent to the difference between both prices, when the exorbitant prices are equal to or higher than US$110 per barrel.

<table>
<thead>
<tr>
<th>Government Take</th>
<th>Rate</th>
<th>Payment Base</th>
</tr>
</thead>
<tbody>
<tr>
<td>Royalties</td>
<td>30% plus 3.33% by way of special advantages</td>
<td>Volume of extracted hydrocarbon</td>
</tr>
<tr>
<td>Special Participation</td>
<td>Surface Tax: 100 tax units per square kilometre.</td>
<td>Area granted not being exploited each year</td>
</tr>
<tr>
<td></td>
<td>Extraction Tax: one third (1/3)</td>
<td>Value of all liquid hydrocarbons extracted from a reservoir</td>
</tr>
<tr>
<td></td>
<td>Export Registration Tax: 0.1 %</td>
<td>Value of all hydrocarbons exported from any port in the national territory</td>
</tr>
<tr>
<td></td>
<td>Special Contribution Based on Extraordinary</td>
<td>Operations related to the international</td>
</tr>
<tr>
<td>Prices: 20 %, and Extraordinary Prices: varying from 80%, 90% and 95 %</td>
<td>exportation for the purpose of selling liquid hydrocarbons (natural or improved) and some byproducts</td>
<td></td>
</tr>
<tr>
<td>---</td>
<td>---</td>
<td></td>
</tr>
<tr>
<td>Fee to the Owner of the Land</td>
<td>N/A</td>
<td></td>
</tr>
<tr>
<td>Signature Bonus</td>
<td>Variable</td>
<td></td>
</tr>
</tbody>
</table>

## 6. Procurement of Goods and Services

### 6.1 Procurement by Public and Government-Controlled Entities

A common public procurement process will typically require pre-enrolment with the relevant NOC or empresa mixta. An individual or open invitation from the NOC or empresa mixta for a tender will follow. The invitee must submit a commercial offer and evidence of its technical, commercial and legal qualifications. Once the bid has been awarded, certain room for negotiations will be allowed until the final services/equipment sales agreement is signed.

### 6.2 Local content Policy

The contracting agency or entity must guarantee in the public contracts that it will include goods and services produced in the country with resources arising from public financing and meeting the respective technical specifications, by designing objective evaluation criteria and criteria of an incentive nature, which should be identified in the invitation to bid, and should be set forth in detail in the bidding conditions, assigning priority thereto.
In selecting offers whose prices are no greater than five percent (5%) higher than the best offer evaluated, one should give preference to that which meets the following criteria according to the bidding conditions:

1. Regarding the acquisition of goods, the offer that has the highest national value added.

2. Regarding contracts for works and services, the offer that is submitted by a bidder whose main domicile is located in Venezuela, has the highest percentage of national parts and inputs, and the highest participation of national human resources, even at a management level.

Once the foregoing criteria have been applied, if the evaluation should result in two or more offers with the same scores, the bidder with the largest national participation in its capital stock will be given preference.

### 6.3 Special Tax Regimes

In Venezuela all three main territorial levels (i.e., Republic, states and municipalities), the Metropolitan District, and the Capital District, have taxing powers. The Constitution, however, grants most of these powers to the national (federal) government, while granting states, municipalities, the Metropolitan District and the Capital District limited and specific powers.

Following is a general overview of the Venezuelan taxation system:

<table>
<thead>
<tr>
<th>Tax</th>
<th>Level</th>
<th>Agency</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income tax, VAT, luxury tax, estate and gift tax, customs duties, financial transaction tax (currently not in force), capital or assets taxes (currently not in</td>
<td>Federal</td>
<td>National Integrated Customs and Tax Administration Service (“Revenue Service”)</td>
</tr>
<tr>
<td>Tax</td>
<td>Level</td>
<td>Agency</td>
</tr>
<tr>
<td>-------------------------------------------------------------------</td>
<td>-------------</td>
<td>---------------------------------------------</td>
</tr>
<tr>
<td>force), production taxes, alcohol and tobacco levies, gaming</td>
<td>Federal</td>
<td>The Revenue Service</td>
</tr>
<tr>
<td>taxes, public registry taxes and fees, and other taxes, levies,</td>
<td></td>
<td></td>
</tr>
<tr>
<td>fees or special contributions not assigned to states or</td>
<td>Federal</td>
<td>Ministry of the People’s Power of</td>
</tr>
<tr>
<td>municipalities</td>
<td></td>
<td>Petroleum and Mining</td>
</tr>
<tr>
<td>Stamp tax in federal dependencies, Venezuelan consulate offices,</td>
<td>Federal</td>
<td>Venezuelan Office of the Superintendent of</td>
</tr>
<tr>
<td>and certain states</td>
<td></td>
<td>Banks and Other Financial Institutions</td>
</tr>
<tr>
<td>Mining and hydrocarbons taxes, including oil windfall taxes</td>
<td>Federal</td>
<td>National Telecommunications Commission</td>
</tr>
<tr>
<td>Special contribution imposed on the average of assets of</td>
<td>Federal</td>
<td>National Institute of Socialist Training and</td>
</tr>
<tr>
<td>financial institutions</td>
<td></td>
<td>Education</td>
</tr>
<tr>
<td>Telecommunications taxes</td>
<td>Federal</td>
<td>Social Security Institute (“IVSS”)</td>
</tr>
<tr>
<td>Special contributions to the National Institute of Cooperative</td>
<td>Federal</td>
<td></td>
</tr>
<tr>
<td>Education</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Special contributions to Pension and Health Systems</td>
<td>Federal</td>
<td></td>
</tr>
<tr>
<td>Tax</td>
<td>Level</td>
<td>Agency</td>
</tr>
<tr>
<td>--------------------------------------------------------------------</td>
<td>------------------</td>
<td>---------------------------------------------</td>
</tr>
<tr>
<td>Special contributions to the Housing and Habitat Payment System</td>
<td>Federal</td>
<td>National Housing and Habitat Bank</td>
</tr>
<tr>
<td>Special contributions to the Employment Payment System</td>
<td>Federal</td>
<td>IVSS</td>
</tr>
<tr>
<td>Telecommunications Taxes</td>
<td>Federal</td>
<td>National Telecommunications Commission</td>
</tr>
<tr>
<td>Special contributions under the Organic Drug Law</td>
<td>Federal</td>
<td>National Anti-drugs Office</td>
</tr>
<tr>
<td>Special contributions under the Organic Law on Science, Technology and Innovation</td>
<td>Federal</td>
<td>National Observatory of Science and Technology</td>
</tr>
<tr>
<td>Special Contribution under the Organic Law on Sports, Physical Activity and Physical Education</td>
<td>Federal</td>
<td>National Sports Fund</td>
</tr>
<tr>
<td>Stamp tax, tolls on state highways, fees for the use of state services and assets, and other taxes</td>
<td>State</td>
<td>State Tax Agency</td>
</tr>
<tr>
<td>Fees for the use of municipal services and assets, and other taxes</td>
<td>Metropolitan District</td>
<td>District Tax Agency</td>
</tr>
<tr>
<td>Stamp tax, fees for the use of municipal services and assets,</td>
<td>Capital District</td>
<td>District Tax Agency</td>
</tr>
</tbody>
</table>
Venezuelan taxes are normally self-assessed and tax returns and other tax relevant documentation are covered by a bonafide presumption. The Tax Administration is empowered by law to audit taxpayers and to issue deficiency assessments. As a general rule, the statute of limitations for tax liabilities is six years. This period, however, may be extended to ten years in certain circumstances.

The income tax liability is determined on three separate bases: (i) net operating income from Venezuela sources; (ii) the adjustments for inflation of the taxpayers’ non-monetary Venezuelan assets and liabilities; and (iii) net operating income from foreign sources. The combination of the three will result in the taxpayers’ net taxable income, to which the relevant tax rates will apply.

Corporations, limited liability companies, stock limited partnerships organized under Venezuelan law, branches of foreign corporations, permanent establishments of foreign companies, and unregistered foreign entities of any nature (e.g., foreign partnerships) with taxable income from Venezuelan sources, other than income from oil production and related activities, are subject to progressive tax rates, depending on the amount of net taxable income, again represented by Tax Units. The applicable rates

<table>
<thead>
<tr>
<th>Tax and other taxes</th>
<th>Level</th>
<th>Agency</th>
</tr>
</thead>
<tbody>
<tr>
<td>Turnover tax on economic activities, industry, trade, services and similar activities; real estate property tax; advertising tax; vehicle tax; and fees for the use of municipal services and assets</td>
<td>Municipal</td>
<td>Municipal Tax Agency</td>
</tr>
</tbody>
</table>
are 15% on the first 2,000 Tax Units, 22% on the excess of 2,000 Tax Units up to 3,000 Tax Units, and 34% on the excess of 3,000 Tax Units (Tariff No. 2). The effective tax rate in this category is essentially 34%. Interest arising from loans granted by non-domiciled financial institutions is subject to a flat 4.95% rate. Oil companies are subject to a 50% rate, while mining royalties are subject to a 60% rate. As of February 11, 2016, a Tax Unit is equal to VEF 177.00 (USD 0.44 at the official DICOM exchange rate in force as of May 6, 2010 of VEF 399, 15 per USD 1), subject to subsequent annual adjustments normally made within the two first months of the fiscal year, and based on the National Consumer Price Index variations of the immediately preceding calendar year.

Venezuela has adopted a simple foreign tax credit which will allow Venezuelan taxpayers subject to worldwide basis to claim a tax credit for taxes paid abroad levied on foreign source income. The tax credit is subject to an overall limitation pursuant to which the foreign tax paid would not be creditable to the extent it exceeds the maximum Venezuelan tax rate applicable therein (i.e., 34%). There is no indirect foreign tax credit for dividends paid by foreign companies and received by resident individuals or entities. There is also no carry forward or carry back for foreign taxes paid otherwise not creditable in a given fiscal year.

Business taxpayers may generally deduct normal and necessary Venezuelan source expenses and losses incurred in obtaining Venezuelan source income. Net operating losses may be carried forward for three years. Losses arising from inflation adjustments may be carried forward for one year. Foreign losses may only offset foreign source income.

The purchase and import of goods and services are subject to a value-added tax (VAT). Currently, the applicable rate is 12% of the gross price (certain luxury items are subject to an additional 10% rate, while certain items are subject to a reduced 8% rate). The rendering of professional services to any Public Entity, including PDVSA and oil mixed companies, is subject to a reduced 8% rate. The sale of natural hydrocarbons by the
mixed companies to PDVSA and its affiliates are subject to a 0% rate. A 75% VAT withholding applies in certain cases.

7. **Environmental Liability**

The environmental provisions applicable in the case of oil spills or environmental accidents are mainly, but not exclusively, set forth in:

(a) The Organic Law of the Environment (“OLE”), which is the framework legislation on environmental matters;

(b) The Criminal Law of the Environment (“CLE”), as revised in 2012 (“2012 CLE”), which regulates the criminal offenses related to the conservation, defense and improvement of the environment.

(c) The Law on Substances, Materials and Hazardous Waste (“SMHWL”), which regulates the handling of hazardous substances, materials and waste, including their generation, use, gathering, storage, transportation, treatment and final disposal.

(d) The Law on Waste Management (“LWM”), which establishes certain environmental regulations and criminal offenses related to the treatment and management of solid waste.

(e) The Organic Law on Prevention, Work Conditions and Work Environment (“LOPCYMAT”) which establishes the general framework for occupational health and safety at the workplace, and provides for criminal liabilities in the case of certain violations of that law.

(f) The Law on Marines and Associated Activities (LMA) which establishes that oil refineries, chemical and petrochemical factories, storage and distribution facilities of chemical or petrochemical products, facilities for the supply of liquid fuels that have terminals for loading or discharge of oil in port areas, shall
provide, in the vicinity of the terminals or docks, systems and procedures for the treatment and disposal of petroleum, chemical, bilge water, cleaning of oil, grease and other pollutant waste, as well as the means to prevent and combat spills.

Violations of the Environmental Provisions or of the authorizations granted by the Ministry of the Popular Power for Ecosocialism and Waters (MPPEW) to carry out activities that cause environmental damage are subject to (i) administrative sanctions under the OLE, the SMHWL and the LMW, and, in some instances, (ii) criminal sanctions under the CLE, the SMHWL and the LMW. In addition, the liable party may be ordered to pay monetary damages regardless of whether or not the cause of the damages constitutes a crime.

The CLE and the SMHWL establish that directors and managers of companies which commit environmental crimes may be held criminally responsible, provided that they participated in the actions or omissions which constitute the crime. Additionally, the 2012 CLE provides that “owners of companies” breaching Environmental Provisions could be held criminally responsible if they have “participated in those breaches”. Although the scope of the phrase “owners of companies” is not a term of art and is quite unclear, it may be applicable to Shareholders of companies incurring in violations of the CLE.

Directors, either principal or alternate, and representatives (including Managers and/or similar personnel) of the Company will be criminally liable in case of certain violations of the H&S Provisions to the extent of their individual and personal participation in each case. Direct and indirect Shareholders are not criminally liable in case of violations of those provisions.

Particularly, if the Company incurs in serious or very serious infringements of the rules governing occupational safety and health and as a result a worker has died or been disabled, the Company or its representatives (i.e.,
Directors, either principal or alternate, and/or Managers and/or similar personnel, but not direct or indirect Shareholders) will be subject to the following penalties to the extent of their individual and personal participation in each case:

(a) temporary disability: imprisonment from two months to two years;

(b) temporary disability: imprisonment from two months to two years or from two to four years if the worker is not able to perform the most elementary acts of daily life;

(c) permanent partial disability: imprisonment from two to four years;

(d) permanent total disability for performing the usual trade: imprisonment from four to seven years;

(e) permanent total disability for performing any type of labor activity: imprisonment from five to eight years;

(f) permanent total disability associated to the worker’s inability to perform the most elementary acts of daily life: imprisonment from five to nine years;

(g) death: imprisonment from eight to ten years.

Civil liability will also ensue in case of oil spills or environmental accidents. Such liability will be based on Articles 1185 and 1193 of the Civil Code. Particularly the latter provision would allow for a quasi-strict liability standard, permitting the defendant only a very limited variety of defences.
Natural Gas Exploration, Development Production

1. **Industry Background**

The exploration and exploitation activities of non-associated gas may be undertaken directly by the State or indirectly through State-owned companies, either alone or with the participation of national or foreign private investors, or by national or foreign private investors on their own.

Private investors who wish to engage in exploration and exploitation activities, on their own or with the State’s participation, must obtain a license issued by the Ministry of Petroleum.

More recently the government has expressed that a minimum State participation of more than 50% of the capital stock of the operating mixed company will be required.

2. **Legal Framework**

The 2006 modification of the OLH confirms that activities related to gaseous hydrocarbons (besides those associated with petroleum) are to be governed by the Gas Law, published in the Official Gazette N°36,793 of September 23, 1999, and its Regulations (“Gas Law Regulations”), published in the Special Official Gazette N° 5,471 of June 5, 2000. The Regulations contain a great deal of substantial rules that, together with the Gas Law, govern the gaseous hydrocarbons industry.

One of the main purposes of the Gas Law is to separate the production of natural gas from the production of oil, thus releasing non-associated gas exploration and production and natural gas processing and refining from the ties of the Hydrocarbons Industry and Trade Law. Hence, non-associated gas may be produced free of the limitations set by OPEC and or any other limitations that affect the production of crude oil. One of the
main benefits of the Gas Law is that it opens the entire industry to national and international private investment.

The Gas Law purports to create a competitive environment for the development of the industry: it orders the functional separation of production, transportation and distribution activities, establishes a regulatory entity to be named the National Gas Entity (Ente Nacional del Gas) and allows other operators access, under equal conditions, to the facilities for storage, transportation and distribution.

3. **Major Industry Players**

Same as in the case of the oil industry

3.1 **Relationship among the Government, NOC and IOCs**

As in the case of the oil industry, PDVSA together with the Ministry of Petroleum play the most significant role in the gas sector. ENAGAS, or the National Gas Entity, a regulatory agency, is another important player, although subject to the guidelines and instructions of PDVSA and the Ministry. IOC may participate either as service providers or shareholders of companies holding E&P rights.

As mentioned above, on February 2016, the government created CAMIMPEG, a wholly-owned State company ascribed to the Ministry of Defense. CAMIMPEG does seem to have the authority to carry out the activities of exploration and exploitation of gas.

4. **Acquiring E&P Rights**

4.1 **Licensing Rounds**

Generally, public biddings are implemented in order to grant gas exploration/exploitation rights. Bidding processes are open to interested parties. Foreign companies and consortia are allowed to participate. NOCs and participants from friendly countries will be preferred.
4.2 Granting Instruments

Licenses may be granted for a maximum term of 35 years, extendable for a term that may not exceed 30 years. The license confers upon its holder the exclusive right to engage in exploration and exploitation activities pursuant to the terms established therein. The rights conferred through the licenses are not subject to encumbrances or foreclosures, but may be assigned with the prior approval of the Ministry of Petroleum.

According to the Gas Law, all assets and facilities related to exploration and exploitation activities performed during a license are subject to reversion. This is the right of the Republic to acquire title to all the assets and facilities used by the license holder to achieve the purpose of the license on the date it expires for whatever reason. In this case, title to the assets and facilities is transferred to the Republic free of liens and without any indemnification.

Controversies between the Republic and the license holder may be resolved by arbitration. If the parties agree to submit the controversy to arbitration, Venezuelan courts will not have jurisdiction. However, the courts may provide assistance in the arbitration proceedings if, for example, the arbitration panel issues precautionary measures of attachment or another similar measure.
5. **Government Takes**

The Gas Law provides that the holders of licenses for the exploration and exploitation of non-associated gas must pay a 20% royalty on all the natural gas extracted from any reservoir and not reinjected.

The Ministry of Petroleum, at its sole discretion, may demand the royalty in cash or in kind. Although neither the Gas Law nor the Regulations contain any provision that allows the royalty to be reduced, it would seem that such a reduction is legally possible because the National Executive is authorized to demand only a portion of the royalty due from the license holder.

The Resolution N° 244 issued by the Ministry of Petroleum and Mining, published in Official Gazette N°38,353 of January 9, 2006, sets forth the methodology to calculate the royalties on non-associated natural gas.

<table>
<thead>
<tr>
<th>Government Take</th>
<th>Rate</th>
<th>Payment Base</th>
</tr>
</thead>
<tbody>
<tr>
<td>Royalties</td>
<td>20%</td>
<td>Volume of extracted gas</td>
</tr>
<tr>
<td>Special participation</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Fee to the owner of the land</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Signature bonus</td>
<td>Variable</td>
<td></td>
</tr>
</tbody>
</table>

6. **Procurement of Goods and Services**

6.1 **Procurement by Public and Government-Controlled Entities**

Same as in the case of the oil industry
6.2 **Local Content Policy**
Same as in the case of the oil industry

6.3 **Special Tax Regimes**
Same as in the case of the oil industry

**7. Environmental Liability**
Same as in the case of the oil industry

[Revised as of July 2018]
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Baker McKenzie helps clients overcome the challenges of competing in the global economy.

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