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# How Will Brazil's Pre-Salt Regulatory Debate Turn Out?

Inter-American Dialogue's Latin American Energy Advisor

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***Q and A: How Will Brazil's Pre-Salt Regulatory Debate Turn Out?***

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The Brazilian government last month released a long-anticipated plan for sharing oil royalties among states. However, congressional leaders have continued to struggle to broker a compromise with producer and nonproducer state governments, which are each threatening to challenge proposals they deem insufficient in court. The deal is a requirement to implement the government's new framework for exploration and production of the country's massive subsalt reserves. What are the main obstacles to reaching a deal? How likely is the government to reach an agreement before the end of the year? When is Brazil likely to be able to conduct a new bidding round for the pre-salt area?

**A: Kirk Sherr, member of the Energy Advisor board and president and managing director of Regester Larkin Energy North America in Washington:**

"It is hardly surprising that the amendment to distribute pre-salt royalties is still deadlocked in the Brazilian legislature. The law which shifted the Brazilian oil regime to a production-sharing system included the 'Ibsen Amendment' which sought an egalitarian split in government revenue from subsalt royalties. Vetoed by President Lula in 2010 on the insistence of governors from oil-producing states, the divisive legislation has yet to find a form that appeases both producing and nonproducing states. The Brazilian government made concessions to the nonproducer states last week, but there is still concern that the legislation could end up before the Supreme Court no matter which direction the legislature takes. There are two potential scenarios for passing the amendment, each with a different timeline. (1) The government's plan passes through the Senate and there is no vote on Lula's veto; royalties are more equitable but still slightly favor producing states; legislation is finalized before the end of October and bidding begins in early 2012. (2) No agreement is reached on the government's plan due to entrenched geographic partisanship; the veto is removed in Congress, and as a result, producing states bring the matter to the Supreme Court; legislation continues to be gridlocked until mid-2012. It seems that the first scenario (slightly more equitable distribution of royalties) is on track, which would allowing for an early 2012 bid round if the final legislation is not challenged by one side or the other."

**A: John Albuquerque Forman, president of J Forman Consultoria in Rio de Janeiro and former ANP director:**

"With the discovery by Petrobras of the subsalt resources in Brazil, announcements were made of a huge potential for oil and gas, and the government take from future production was estimated in the range of \$1 billion. Rather than adjust the level for the 'participação especial' that is charged on high-production, high-revenue fields, which could be done by a simple alteration of a government decree, the decision was made to modify the form of taxing these revenues by using the production-share formula. Whereas the distribution of royalties and special participation revenues is well detailed in the Petroleum Law (Law 9478/1997) with percentages attributed to the municipal, state and federal treasuries, the revenues from the subsalt resources would be used by the federal government to create a special fund. When the proposals for the changes were sent to Congress, at first there was the claim from nonproducing states and municipalities that because the location of these new resources was distant from the coast, they should be distributed equally among all states and municipalities and the federal share should be diminished accordingly. Then came the idea that all revenues, whether from subsalt resources or from the present concession contracts, should also be equally shared. President Lula vetoed this. It is doubtful that any congressman will vote in favor of the producing states only and 'against' the nonproducing ones, which of course do not want that to happen. It is going to be a long and difficult debate before any new distribution scheme will be approved. Until then, no bid rounds for the subsalt area and, as a consequence, for other areas where the present concession system applies."

**A: Isabella Alcañiz, post-doctoral fellow and visiting professor at The Lauder Institute at the Wharton School of the University of Pennsylvania:**

"Last year, the Brazilian Congress agreed to do away with the old co-participation scheme, which benefited oil producing states, by passing a framework that divided oil revenues equally among all states. President Lula vetoed it. At present, Congress appears to be at a standstill because nonproducing states want to overturn Lula's veto while oil producing states want the status quo. President Dilma's government is pushing for new legislation that nevertheless can be accepted by producer states in order to avoid future legal nightmares. With a coalition majority in both chambers, a number of legislative prerogatives (including urgency motions), and a strong incentive to move forward swiftly, it seems likely the government will get its new plan by the end of this congressional session or the beginning of the new one in February 2012. A proposal by a Workers Party senator, already in commission, could do just that. It calls for oil revenues being split 60-40: 60 among all states and the federal government and the rest for oil producers. While negotiations will be difficult, the decision by congressional leaders to schedule a vote on this proposal, before the planned vote on Lula's veto, is good news for the government. Proponents have already signaled that it could contain short-term compensations for oil states. If passed, the bidding for presalt-area drilling by late 2012 can go ahead as scheduled."

**A: Paulo Valois, partner at Schmidt, Valois, Miranda, Ferreira & Agel in Rio de Janeiro:**

"The issues involving the allocation of the government take among the states have started with the enactment of the new legal regime (production sharing agreement) for the exploration of the presalt layer. Under the PSA regime, the so-called special participation will no longer exist. The royalties and special participation revenues under current and future concessions will be split among producing and nonproducing states. The producing states (such as Rio de Janeiro State) will therefore lose a substantial portion of their revenues. The states have not reached an agreement yet and if the new allocation is approved, it is likely that the issue will be resolved by the Supreme Court. It is hard to anticipate whether the states will converge until the end of the year. I don't expect a round for the pre-salt in 2012."

*The Energy Advisor welcomes responses to this Q&A. Readers can write editor Gene Kuleta at [gene.kuleta@thedialogue.org](mailto:gene.kuleta@thedialogue.org) with comments.*