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Brazil on Track to Manage its Oil Bonanza Effectively?

Inter-American Dialogue's Latin American Energy Advisor

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Q and A: Brazil on Track to Manage its Oil Bonanza Effectively?

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As Brazil ramps up exploration and production in the pre-salt oilfields, the country has expectations of joining the ranks of the world's top four or five oil producers. A relatively minor spill at Chevron's Frade field, however, brought to light issues of environmental concern as well as questions about how such incidents would be handled. Is the country prepared with the right regulations to handle the mushrooming industry? What does the government's response to the Chevron spill mean for the development of the sector? Could the threat of large fines deter investment? Is the growing oil sector putting a significant strain on the country's resources? Is Maria das Graças Foster the right person to lead Petrobras during this period of growth?

A: Cleveland M. Jones, professor and researcher at the National Institute of Oil and Gas at the State University of Rio de Janeiro:

"The Chevron spill is being used to advance a political agenda that seeks to limit the role of foreign oil companies in Brazil. The government (read President Dilma Rousseff) knows that this path is dangerous and may compromise the future potential of Brazilian oil production, so this agenda will not be taken to the extreme as experienced in Venezuela, although the playing field will be skewed in favor of Petrobras. Because of the close relationship between the new president of Petrobras, Maria das Graças Foster, and President Rousseff, Petrobras and the entire Brazilian oil industry will see further politicization and government control, but that policy will not effectively bar foreign participation. Regardless, Brazil will become a major exporter of oil and refined products. Despite the political and managerial strength of both women, who will control the demagogic politicians from the government's political base of support and from Rousseff's Labor Party itself, which has so far stolen the show, the political risk in Brazil will rise. That increased risk will be translated into a cost which is not readily apparent, but will cost the country far more than any fines and compensation eventually obtained from Chevron. Uncertainty in relation to the legal and operating environment means that any new investments will be subject to higher required returns. The opportunity cost of projects not funded will hurt Brazil in its goal of developing the recent major oil discoveries in the most effective and efficient way, but clearly, political considerations matter more."

A: Kirk Sherr, member of the Energy Advisor board and president of Regester Larkin Energy:

"The rapid pace of Brazilian deepwater development desired by Petrobras must be tempered with the technical, logistical and human resource challenges of operating in these extreme environments. The Chevron spill problem seems to point to regulations aimed more at rapid offshore resource development than at safety and environmental protection. The lack of a comprehensive spill response system, promised for more than a year, once again raises questions of Brazil's capacity to deal with a major spill. Corporate lack of preparedness, planning and response may lead to large fines, criminal action by the government and loss of local corporate reputation. Increased insurance costs and a sector-led response capacity (similar to the Marine Well Containment Company in the United States) are likely outcomes from the incident. Going forward, companies should have well-honed crisis management and response measures, including procedures that are integrated with joint venture partners and the Brazilian government. These added costs (and the technical/labor/bureaucratic challenges in Brazil) plus the threat of fines and criminal prosecution in the case of an accident, may give some companies pause, but are unlikely to seriously deter foreign investment in the near term. Likewise, the development of the offshore fields will not put significant strains on Brazilian resources, as foreign companies will take up any shortfall. In any case, Maria das Graças Foster will have the full support of President Rousseff as she seeks to tackle these issues and, by naming a well-qualified woman to lead the company, Petrobras has accomplished yet another 'first' in the region."

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

"The first of its type in Brazil, the Chevron accident resulted in an overreaction, mostly from outside the country, since many organizations don't know the real situation and questioned the existence of laws, rules and procedures regarding oil spills. Brazil has drafted laws and regulations with the world's most advanced legislation taken into account. Fiscalization of rules and regulations is incipient as, fortunately, there have been no accidents of this type and I don't expect that major occurrences are likely to happen in the future as there are a lot of efforts being undertaken to make sure that HSE regulations are being followed. Chevron's accident was not a major one and was properly controlled in a short time period. The exploration conditions for the pre-salt are much more difficult, so a lot of attention is being given to the safety of operations, especially regarding the environment. It is understandable that after the major Macondo accident in the Gulf of Mexico, where major oil companies operate and in a country that has one of the longest oil exploration histories in the world, people and organizations may conclude that Brazil, a developing country, does not have the know-how or rules to enforce safe operations. It is not the case. When BP bought the Devon assets in Brazil, the transfer was only authorized after the authorities visited the gulf, saw the measures and precautions taken, became satisfied with the changes BP made to its HSE procedures and then considered BP to be in a position to be an offshore operator in Brazil."

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

"Yes, the correct regulations are in place. Brazil has two main administrative bodies regulating E&P activities, the ANP (through the concession contracts) and IBAMA (which regulates environmental issues). Brazil has adopted a performance system with regards to the regulation of these activities (as opposed to the prescriptive system adopted in the United States), and this means that the operators of E&P activities have more freedom to operate. However, this should not be construed as Brazil adopting lenient regulation, and, in case accidents occur, heavy fines may be imposed on such operators (including criminal charges). The response to the recent oil spill seems to have several aspects, especially considering that this was the first oil spill in Brazil after the Macondo incident. Furthermore, this incident has incited further discussions concerning the distribution of oil royalties in Brazil, as it shows that there is always a risk involved in activities of this type, and that the regions which are affected should be the ones that are indemnified for this type of risk and/or accident. The fines should not deter investments, as fines may be judicially discussed. As of this moment, the growing oil sector is not putting a significant strain on the country's resources. However, how this will develop with the constant growth of the industry remains to be seen. Maria das Graças Foster is a technician who has a close relationship with Dilma's government. In this sense, her appointment represents a strengthening of the government's participation in Petrobras' decisions."

A: Isabella Alcañiz, post-doctoral fellow and visiting professor at the University of Pennsylvania:

"It is not so much whether Brazil has the right regulations to deal with the growing oil sector, but whether it has the capacity to enforce them. The Chevron spill demonstrated the lack of close supervision by the regulatory body, the National Agency of Petroleum (ANP). Now, the ANP is paying close attention to the U.S. company, citing it several times over the past few months. The government's seemingly tough stance against Chevron—millions of dollars in fines and suspension of its operating license—is probably not enough to quell serious environmental concerns. After all, a \$28 million fine on a \$200billion company is not a serious enforcement threat. Given the windfall profits expected from subsalt oil production and relatively small government fines, it seems unlikely that investors will be deterred. The wildcard is the judiciary, however. Federal prosecutors from the oil-producing state of Rio de Janeiro are suing Chevron and the drilling company Transocean for \$20 billion to cover the spill's damages. The track record of Brazilian courts track record in addressing environmental grievances is mixed, thus it is hard to predict whether the new lawsuit will succeed. Given multiple competing demands from all stakeholders (oil and nonoil producing states, Brasília, Petrobras and other oil companies) it is not surprising that Dilma Rousseff chose to appoint a close political operator to lead Petrobras in this expansionary stage. The president and Graças Foster worked together at the ministry of energy, when the former led the institution."

The Energy Advisor welcomes responses to this Q&A. Readers can write editor Gene Kuleta at gkuleta@thedialogue.org with comments.