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What accounts for the erosion of interest in Brazil's oil sector?

Inter-American Dialogue's Latin American Energy Advisor

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Q and A: What Accounts for the Erosion of Interest in Brazil's Oil Sector?

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U.S.-based oil company Anadarko has put its plans to sell some of its assets in Brazil on hold, failing to attract a high enough price as interest in the country's oil sector has waned, the Financial Times reported in July. Brazil has not sold new offshore permits for about five years, and state oil company Petrobras has had difficulty in meeting targets for increased production. High local content requirements and perceived political interference have also hampered investment and production, according to government critics. How much has the previously intense excitement about Brazil's oil sector cooled? What are the primary factors that account for the drop in investor interest? What should the government be doing to improve the regulatory and investment environment?

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

"Brazil's oil industry has benefitted from a relatively long and stable period, during which the national petroleum regulatory agency constantly conducted regular rounds of bidding for new exploratory areas, contributing to a healthy balance between exploration, development and production activities. That has all changed since the pre-salt discoveries led to a more restrictive policy toward foreign participation in the sector. Bidding rounds for additional exploratory blocks, which are essential for keeping the industry project pipeline filled, have been suspended, and no new round with attractive areas is likely until next year. Besides putting the brakes on new exploration efforts, an additional contractual regimen (production sharing) was introduced, and a new national oil company, PPSA, was created to supervise all future pre-salt projects. PPSA was born with the power to exercise a much stricter level of government control, including veto power over individual development plans which any consortium may propose for pre-salt exploration areas. These changes, in addition to the perceived unfair and unusually harsh treatment of Chevron in the Frade spill incident of 2011, exposed an operating environment much changed from years past, when Brazil was considered to be a model for regulatory framework development and investment attraction for other countries around the world. Even if the government signals a change in attitude, the damage has been done, and Brazil will continue to pay the price for years to come, as new projects will require higher returns, based on the country's higher perceived risk."

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

"The excitement on the Brazilian upstream has cooled down for a number of reasons, the most important of which are the clear signs issued by the government against opening exploration activities, lack of rounds, unclear rules on the new pre-salt model, uncertainties on the royalties allocation and high local-content requirements. It is indeed very clear these signs are contributing to keep some IOCs outside Brazil, even though others are still waiting for an opportunity to establish a presence in the country and/or to partner with Petrobras. There are also the NOCs that are coming or expect to come to the country anchored on quid pro quo governmental relations with Brasília. To foster investments in the upstream from the IOCs, Brasília should issue concrete measures to welcome newcomers such as establishing a date for the Brazil Round 11 and for the first round on the pre-salt areas. Personally, I tend to believe that the government is looking for new investments on infrastructure such as airport concessions, roads and railroads in the near future. These do not include upstream activities, the opening up of which will follow the capacity of Petrobras and the domestic industry to develop the market."

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

"When the law was changed to allow private companies to bid, Petrobras had all of the knowledge of the petroleum systems and there was an enormous need for information. The prospects were modest. After five years, all the companies, including Petrobras, demanded a reduction of royalties, believing that the only oil to be found in Brazil would be heavy and in deep waters and small fields. Since then, knowledge has progressed very fast and prospects are much better with the pre-salt and other discoveries. The big problem is the distribution of revenues, a change proposed by the federal government that excluded the states and municipalities. This led to a problem with Congress, which then voted to change not only the pre-salt but all revenues, even for existing contracts. The amounts paid under existing contracts will not change, but the distribution arrangements between the federal government, states and municipalities will change. The federal government does not agree, and as the government's participation is under discussion, no new bids will be called. At the moment, the local content rules affect mostly Petrobras, as there are few projects run exclusively by foreign companies. The concession contracts have specific rules to waive the percentages if it is shown that they cannot be met due to availability, production time or cost. But of course, very few people really read long and intricate contracts. The pre-salt development's requirement that Petrobras have at least 30 percent of any project, on top of those for which it is 100 percent responsible, places a heavy burden on the state-run company."

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