

Public tender systems for granting E&P contracts

Brazilian and international experience

The oil and gas discoveries in the pre-salt layers have raised discussion on possible changes to the Brazilian regulatory regime, with interest expressed on more than one occasion from the Executive Branch, the Ministry of Mines and Energy (MME), Petrobras, and the National Congress.

Conflicting opinion and the wealth [of natural resources] have given this topic a multifaceted nature, and they have eclipsed the technical endowment of the regulator, the National Oil, Natural Gas and Biofuels Agency (ANP), when it is the ANP that had imagined to conduct the discussion on regulation in the first place. More recently, by Decree on July 18th 2008, the president of the agency created an interministerial commission with the object of “studying and proposing the necessary alterations to legislation, as far as exploration and production of oil and natural gas is concerned for the newly discovered oil reserves”. This commission is comprised of the Ministries of Mines and Energy, the Cabinet, Planning, and the Treasury; Petrobras, The National Economic and Social Development Bank of Brazil (BNDES); and the ANP. Once again, according to the declarations made after the first meeting of the commission, there is an air of research and perplexity.

Placed within the scope of the comparative work proposed by the commission, allusions to the regulatory regimes of countries such as Russia, Venezuela, the United States, Iran and Norway can be taken into consideration. A comparative analysis is of great relevance, since the institutions of the oil and gas industry involve questions of international law and petroleum law, and must incorporate the best practices of the oil industry, based in the international oil industry.

In Brazil, such studies have been conducted in the past. The evolution of our regulatory framework was centered, as will be shown, in the knowledge attained in this comparative vision. The first comparative study included the first service contracts, notable from Iran, when the service render contract was first drafted with a risk clause (risk contract) adopted by Petrobras at the end of the 1970s until the advent of the Constitution of 1988. Before the enactment of the Petroleum Law, new comparative studies were conducted by enterprises, the Brazilian Institute of Oil, Natural Gas and Biofuels (IBP), and the MME before the creation of the ANP. At the time, the North American, Norwegian and British systems were examined, among others.

The option represented by the sui generis case of Venezuela is not clear, since the country's system evolved into something quite distinct from international practice, mixing service contracts with public-private



Marilda Rosado é a professora on International Law at the Universidade Estadual do Rio de Janeiro (UERJ), Ph.D in International Law of the Universidade de São Paulo, and partner of the law firm of Doria, Jacobina, Rosado e Gondinho Advogados Associados. This article was written in collaboration with Juliana Lima, master in International Law and attorney-at-law at the same law firm.



companies. In the case of Latin America, it would make more sense to analyze other countries, such as Colombia and Peru, which are more mature in the evolution of their regulatory framework, which include several different contractual models. Russia is an example of the production sharing contract, although other countries, more similar to our own judicial system, such as Angola are also representative of this model.

Our current focus is the importance of the political environment surrounding the concession of exploration and production rights of private enterprise. Although many countries still hold direct negotiations, public tender models have advanced internationally. It is important to point out that continuing oil and gas production and exploration activities within the current legal framework, without periodic reorganization of the public tender model, is a pre-requisite not only for the credibility of the country as the object of investment, but also for the maintenance and increase of the nation's oil reserves. An example of this coherence is Norway, where the 19th Bid Round has now been successfully concluded, and the 20th is on the way. In the US, the leasing calendar is approved for 50-year plans, giving even more assurance to the process.

The State, sovereign over its natural resources, may re-evaluate the system from time to time in order to perfect it. Several factors may promote changes in the public tender process of a country: the oil price, increase domestic consumption, the discovery of new exploration frontiers, etc. However, these factors should not jeopardize the principles of relations between the State and investors. Good-faith, legitimate investor expectations, and legal assurance are examples of the principles that govern

international law and the domestic legal environment that integrates with the international community. The sovereignty of states is not unlimited; it should be compatible with and conform to the dictates of the international community.

Another aspect that is an important signal to investors is the transparency of the decision-making process in the broadest context of the public tender system. Clearly defined rules and regulations of the agents involved in system are an important factor in the stability that attracts investments.

In Norway, where the oil and gas industry is responsible for 25% of the GDP, the regulatory framework is well-structured as far as the distribution of powers is concerned. The Parliament is responsible for establishing the legal framework for exploration and production activities. The Norwegian Petroleum Directorate (NPD), the counterpart of the Brazilian ANP, is an independent regulatory agency linked to the Ministry of Petroleum and Energy, whose function it is to manage the natural resources sustainably.

In the USA, a possible basis for comparison is only in the offshore areas, where the State is the owner of rights and not in the hands of private ownership. The US government leases areas on the continental shelf (Alaska, Gulf of Mexico, and the Atlantic and Pacific Coasts) on a fifteen-year plan, which includes various steps of the public tender process (identifying areas, hearing with all interested parties, and the invitation of potential investors). These steps allow for more dynamism and assurance regarding the leasing. However, the credibility of the Mineral Management Service (MMS) at the federal level, by virtue of its pro-active measures to edit rules applicable to the Gulf of Mexico, is an international reference point as an industry regulator.

In Brazil, the roles of the Ministry of Mines and Energy, the National Council for Energy Policy, the ANP, and the Energy Research Company (CNPE), are prescribed by law. However, the CNPE and the Ministry have been exacerbating the powers of the regulator. An example of this can be found in the increasing demands and interference of the CNPE to define the blocks to be placed on auction in the latest bid rounds, and in the withdrawal of the ANP public tender without legal grounds, despite the agency's powers as guaranteed by law. This situation brings the question: are the powers as prescribed by law being respected? It is our opinion that the creation of this commission by decree breaks the material competence of the petroleum regulation as foreseen constitutionally and infraconstitutionally.

The discussion at hand now seems to be divided into two perspectives: those that believe that the pre-salt areas should be submitted to a production-sharing model, and those who support the current concessionary model. This new contracting model is polemic, due to its inherent need to create a new state oil company to manage the exploration of the pre-salt layers. On the other hand, at the Congressional level, there is a trend to defend altering the government's stake, especially regarding royalties. Such alterations would imply two alternatives for the government: revising the Petroleum Law, or altering just the Decree 2.705/98, which foresees government take on oil and natural gas production. Here is where the more technical position of the ANP becomes clear (and supported by the industry), and evidently base on studies of international consultancies that have shown that there is room to increase the rate of the special participation tax, without altering the Petroleum Law.

Production-sharing bring no real benefits to the government, because simply changing contractual models have no way of really increasing government take. Furthermore, there are many valid concerns regarding production-sharing contracts at hand.

Continuing the Bid Rounds guarantees the protection of public interests of the first and second orders because the uptake of diversified technology and capital is done in the interest of society at large. The high technological and financial risks involved in these deep waters and peculiar production characteristics of the pre-salt layers require significant financial resources, which will depend on attracting foreign investment.

Thus, any change in the institutional model should be done in the long-term and with the



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approval of the National Congress. The government and the concessionaires invested in the 8th Bid Round; revoking the Bid Round, as well as the lack of assurance about future bid rounds, is delaying the process by years until exploration efforts in the blocks of the 8th Bid Round are recommenced.

The Constitution of 1988, in the same way as the Brazilian legal framework, established principles to govern the international relations of Brazil, in accordance with the international legal order. It is for that reason that Brazil should seek stability with its investor relations in the interest of society at large, and preserving the so-called energy self-sufficiency of the nation.

Holding discussions on possibly altering the Brazilian institutional model can be done without freezing the public tender process of bid rounds, which have been so successfully implemented in Brazil for ten years. The year 2008 may be a hallmark in the evolution of the petroleum industry of Brazil. However, one cannot sow the seeds of the future on solid ground if the success of the last ten years is taken for granted. The benefits of these new heights will be felt even more if we preserve our success on legal grounds. ■