Petroleum production sharing: thinking about the new reform*

Partilha de produção petrolífera: reflexões sobre a nova reforma

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ABSTRACT

This essay proposes to reflect on the status and prospects of the non-competitive system of "production sharing" after the regulatory reform in 2016. In fact, although the regulation of the economic agents involved in the development of fields in pre-salt areas is not properly insecure, it is also certain that it cannot be called stable. Indeed, only a decade after the discovery of the pre-salt, the legal protection of its exploration has already been the subject of three important Federal Laws: 9.478/1997 (LP), 12.351/2010 (LPP) and, more recently, 13.365/2016. With the latter, the regimes established in the LP and in the LPP gained novelties of relevant practical repercussion in the scope of the state regulation on the exploration of the pre-salt, especially on the Petrobras function. In this paper, we intend to contribute to the debate about the legal changes made at the end of 2016, relating them to the

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competitive and production-sharing systems and anticipating prospective results of interest to the Oil and Natural Gas Industry (IPGN).

KEYWORDS

Regulation — competition law — pre-salt — production sharing — changes in law

RESUMO

Este ensaio se propõe a apresentar reflexões sobre o *status* e as perspectivas do sistema *não concorrencial* da "partilha de produção" após a reforma regulatória ocorrida em 2016. De fato, embora o regime jurídico ao qual se sujeitam os agentes econômicos atuantes no desenvolvimento de campos em áreas de pré-sal não seja propriamente *inseguro*, é também certo que ele não pode ser chamado de *estável*. Com efeito, apenas uma década após a descoberta do pré-sal, a tutela jurídica de sua exploração já foi alvo de três diplomas de peso: as Leis Federais nºs 9.478/1997 (Lei do Petróleo — LP), 12.351/2010 (Lei da Partilha de Produção — LPP) e, mais recentemente, a 13.365/2016. Com esta última, os regimes estabelecidos na LP e na LPP ganharam novidades de relevante repercussão prática no âmbito da regulação estatal sobre a exploração do pré-sal, destacadamente no que tange ao papel da Petrobras. Neste trabalho, pretende-se contribuir com o debate a respeito das alterações vigentes ao final de 2016, relacionando-as aos sistemas concorrencial e de partilha de produção e antevendo resultados prospectivos de interesse para a indústria do petróleo e gás natural.

PALAVRAS-CHAVE

Regulação — direito concorrencial — pré-sal — partilha de produção — mudanças legislativas

1. Introduction

The ticking of the clock does not stop, nor does the passing of time. [...].

Robert Stephenson[1]

[1] STEPHENSON, Robert. Time does not stop. In: WIGNEY, Tessa et al. (Org.). *Journeys with the black dog*. New South Wales: Black Dog Institute, 2007. pg. 323.

Ten years ago, Brazil and the world were feeling the results of the discovery of the pre-salt oilfields. At the height of the Bidding Rounds (RLs) for exploratory blocks of oil and gas, managed by the ANP[2], the CNPE[3] issued Resolution No. 6/2007,[4] excluding 41 areas[5] from the 9th RL — some 13% of the total. The resolution also determined[6] that the Ministry of Mines and Energy (MME) should make an assessment, as soon as possible, of the changes in the legal framework required to create "a new paradigm for oil and gas exploration and production".

Since then much has been done and redone in this "invisible web on which everything can be embroidered"[7] that we call time, and the government regulation of the research, development and production in pre-salt areas has been subject to a variety of legal regimes that are incompatible with more usual parameters for normative stability.

This scenario, it is true, cannot be tarred with the brush of legal uncertainty. The reason is simple: whatever the regulatory framework at the time of signature, the administrative contracts obeyed it and have been respected by the ANP. At no time did the government insist that Brazilian or foreign companies should be included in or excluded from pre-salt areas by force of law.

On the other hand, the flagrant *legal instability* relating to this activity is in contrast to the international practice in significant markets like oil. It is almost laughable that, in just one decade, government regulation of the pre-salt areas has been subject to at least three weighty laws: Federal Laws 9.478/1997 (the

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2 Agência Nacional do Petróleo, Gás Natural e Biocombustíveis (National Oil, Natural Gas and Biofuels Agency).

3 Conselho Nacional de Política Energética (National Energy Policy Council). About its work on the rational use of energy resources, see FELISMINO, Larissa Soares; GUEDES, Sânzia Mirelly da Costa. A atuação do Conselho Nacional de Política Energética (CNPE) no aproveitamento racional dos recursos energéticos. In: XAVIER, Yanko Marcius de Alencar et al. (Org.). *Direito do petróleo e gás natural:* estudos em homenagem ao professor José Romualdo Dantas Vidal. Natal: EDUFRN, 2013. pg. 129-148.

4 "Sets forth specific guidelines for the holding of the Ninth Bidding Round for exploratory blocks by the National Oil, Natural Gas and Biofuels Agency (ANP) and makes other provisions."

5 26 blocks in the Santos Basin, 13 in the Campos Basin and 2 in the Espírito Santo Basin.

6 Article 4 To instruct the Ministry of Mines and Energy to assess, as soon as possible, the changes necessary in the legal framework to introduce a new paradigm for the exploration and production of oil and natural gas, arising from the discovery of the new oil province, respecting the contracts currently in force.

7 ASSIS, Machado de. *Esaú e Jacó*. Rio de Janeiro: ABC Editora, 2005. pg. 46.

Oil Law — LP), 12.351/2010 (the Production Sharing Law — LPP) and, more recently, Law 13.365/2016.

The purpose of this study is to comment on the new law, No. 13.365/2016. It has introduced new elements into the *pro-competition* regime of the LP — and the possibly *anticompetitive* LPP — which will have a significant effect on government regulation of the pre-salt areas. My inquiry, starting with the basic aspects of the regulatory phenomena, will cover the stages of development of the pre-salt regulation. I shall then use Popper's social scientific method to identify and deal with any problems found, in particular those related to the subjective easing in contracting Petrobras as operator of exploratory blocks, comparing it to the regimes enshrined in the LP and the LPP.

2. Elementary aspects of the regulation

The term *regulation* arose in the United States in a context where industries had a monopoly, and there was a demand for prices to be fixed by the State. Over time, circumstances changed and there was a call for certain sectors to be opened up to private initiative. When the legislation protecting monopolies was *suppressed*, it became clear that it had not been substantially *superseded*. Thus the government continued to define precepts with a view to the real dismantling of the previous legal protection. It became clear that more rules would have to be determined than in the past.[8]

Changes in the understanding of how regulation is practiced in Brazil led to a distinctive view of the institution. Today we understand it as a set of legislative, administrative or conventional measures which restrict personal freedom and determine, control or influence the behavior of economic agents, requiring them to comply with constitutional principles, in particular those

[8] FONSECA, João Bosco Leopoldino da. Concorrência e regulação. In: CAMPILONGO, Celso Fernandes; MATTOS, Paulo Todescan Lessa; ROCHA, Jean Paul Cabral Veiga da (Org.). *Concorrência e regulação no sistema financeiro*. São Paulo: Max Limonad, 2002. pg. 223; GUERRA, Sérgio. Direito administrativo e a nova hermenêutica: uma releitura do modelo regulatório brasileiro. *Revista de Direito Administrativo*, São Paulo, v. 243, pg. 178, Sep./Dec. 2006.

of an economic and social nature.[9] It is, so to speak, a form of government intervention in the economy.[10]

So what is needed is an exclusively normative bias, even though there can be *regulation* by means of *ruling*.[11] This is precisely the idea of article 174[12] of the Federal Constitution, which treats the two procedures as complementary, registering the fact that the State is a *normative* and *regulatory* agent of economic activity.

In truth, while the State was intervening directly in the economy, drafting these measures was not essential, and up to a point, of no interest. However from the time when economic activity started to be undertaken by the private sector as well, it became inexcusable — for numerous reasons — to densify the regulatory apparatus in order to ensure protection of the public interest.[13]

But this is only one of the facets of the mechanism which guides the economy. Nowadays, one can say that the State exercises a regulatory economic activity both when it grants concessions to private companies to operate their business or provide public services, and when it plans rules aimed at protecting the environment or the consumers.[14]

And it is in this sense that Floriano Marques Neto classifies the hypotheses for promoting regulation in three distinct categories: anti-competitive, non-competitive and pro-competition.[15]

The first category does not require much explanation. It is intervention that shuts down competition. It is the practice of an exclusive monopoly by a state operator, which both regulates and exercises the economic activity. It is

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9 ARAGÃO, Alexandre Santos de. Regulação da economia: conceito e características contemporâneas. *Revista do Direito da Energia,* São Paulo, v. 1, n. 2, pg. 162, Oct. 2004.

10 FONTES, André. Regulação e petróleo. *Revista Brasileira de Direito do Petróleo, Gás e Energia,* Rio de Janeiro, n. 2, pg. 225-237, 2006-2009. pg. 225.

11 Ruling relates to normativity, being a general, abstract state act of a materially legislative nature, with two main sub-species: regulations for execution (secondary normative acts, with their validity based on infraconstitutional laws in the broad sense) and independent ones (primary normative acts, with their validity based directly on the Constitution). ALMEIDA, Fernando Dias Menezes de. Considerações sobre a "Regulação" no Direito Positivo Brasileiro. *Revista de Direito Público da Economia,* Belo Horizonte, v. 3, n. 12, pg. 75-79, Oct./Dec. 2005.

12 Article 174. As a normative agent and regulator of economic activity, the State shall exercise, in the form of the law, the functions of supervision, incentive and planning, with the latter being a requirement for the public sector and recommended for the private sector. [...].

13 MARQUES NETO, Floriano Peixoto de Azevedo. *Regulação estatal e interesses públicos.* São Paulo: Malheiros, 2002. pg. 167.

14 SALOMÃO FILHO, Calixto. *Regulação da atividade econômica.* São Paulo: Malheiros, 2001. pg. 15.

15 MARQUES NETO, Floriano Peixoto de Azevedo. A Articulação entre regulação setorial e regulação antitruste. *Revista Regulação Brasil,* Porto Alegre, v. 1, n. 1, pg. 69-88, Jan./Dec. 2005. pg. 71-72.

what happened with the IPGN before Constitucional Amendment No. 9/1995 and what still happens in the postal service.

In the non-competitive category, while there is no prohibition to the institution of competition, nor is it encouraged. The State takes a neutral position, focusing its regulation on areas other than competition, such as sovereignty, the universalization of services, regional integration, the environment, quality of services.[16]

Finally, the pro-competition model is more in line with current regulatory trends, representing government intervention focusing primarily on the introduction and promotion of competition. Competition in this scenario is seen as the right channel for the regulator to achieve its public objectives. It is the key method today of regulating not just the IPGN, but also electricity and telecommunications services.[17]

Whichever model is adopted, any social grouping which wishes to have a sustainable basis for its economic structure must adopt a minimum regulatory framework in order to ensure the best possible performance in the public interest.[18]

3. Development of regulation of the pre-salt areas

Originally, the 1988 Constitution of the Federative Republic of Brazil provided that oil exploration, drilling and refining were state monopolies, and could only be undertaken by government companies, with any sort of assignment, concession or participation being prohibited.[19] Constitutional Amendment No. 9/1995 introduced the phenomenon of *easing of the monopoly:*

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16 OLIVEIRA, Gesner; RODAS, João Grandino. *Direito e economia da concorrência.* Rio de Janeiro: Renovar, 2004. pg. 139-140.

17 Floriano Peixoto de Azevedo Marques Neto, *A articulação entre regulação setorial e regulação antitruste*, op. cit., pg. 72-73.

18 SALOMÃO FILHO, Calixto. *Direito concorrencial:* as estruturas. 2nd ed. São Paulo: Malheiros, 2002. pg. 19. In spite of the lack of determination, the public interest must be understood as the sum of individual interests coinciding around a life asset which are seen as a value, gain or utility of a moral or material type. The primary ones are the real foundations of the State, i.e. the offer of justice, safety and social wellbeing. The secondary ones, in turn, are those that make it possible to realize the primary ones, represented, generically, by the interests of the public treasury. BORGES, Alice Gonzales. Supremacia do interesse público: desconstrução ou reconstrução? *Revista de Direito do Estado,* Rio de Janeiro, n. 3, pg. 143-148, Jul./Sep. 2006. See also SIQUEIRA, Mariana de. *Interesse público no direito administrativo brasileiro:* da construção da moldura à composição da pintura. Rio de Janeiro: Lumen Juris, 2016. pg. 17-106.

19 Article 177, paragraph 1.

the Federal Government, although not giving up its monopoly, could now contract *private companies*[20] to do the work.[21]

The change in the law led to an influx of new players into the Brazilian economy, with demands for the creation of a regulatory entity to provide incentives, planning and supervision, and this was achieved with the establishment of the ANP by the Oil Law.

3.1 The issue under the Oil Law (1997)

The LP also established the values and objectives of the National Energy Policy. Allied with the general principles of constitutional economic and financial order, these are still the parameters for action by legislators and appliers of the law in the sense of preserving the national interest, promoting the country's development and competitiveness, protecting the interests of the consumer, the environment and free competition, and attracting investments.[22]

Throughout more than a decade, the objectives outlined in the National Energy Policy were attained by the ANP by means of a regulatory model for concession contracts for areas of exploratory risk, preceded by bidding.[23] The adoption of this model was essential for the development of the IPGN in Brazil, where almost 70% of the territory consists of sedimentary basins — formations that are geologically propitious for the formation and accumulation of oil and gas.[24] In fact, the vast expanse of Brazil — the fifth largest country in the world in terms of area — has always precluded the possibility of a single company mapping, exploring, developing

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[20] Now and throughout this study I shall use the term *"company"* in the *subjective* acceptance of Asquini. ASQUINI, Alberto. Profili dell'impresa. Translated by Fábio Konder Comparato. *Revista de Direito Mercantil, Industrial, Econômico e Financeiro,* São Paulo, v. 35, n. 104, pg. 109-126, Oct./Dec. 1996. pg. 114-115.

[21] See the new wording of article 177, paragraph 1: "The federal government may contract state or private companies for the activities described in items I to IV of this article, subject to the provisions of the law".

[22] Concerning the constitutional format of the IPGN, see MARTINS, Daniela Couto. *A regulação da indústria do petróleo segundo o modelo constitucional brasileiro.* Belo Horizonte: Fórum, 2006. pg. 13-65.

[23] For relations between the activities of the ANP and the Oil Law, see BUCHEB, José Alberto. *Direito do petróleo:* a regulação das atividades de exploração e produção de petróleo no Brasil. Rio de Janeiro: Lumen Juris, 2007. pg. 18-146.

[24] AGÊNCIA NACIONAL DO PETRÓLEO, GÁS NATURAL E BIOCOMBUSTÍVEIS. *Tenth round will offer 162 onshore blocks.* Available at: <www.anp.gov.br/conheca/noticias_int.asp?intCodNoticia=304>. Accessed on: Sep. 23, 2008.

and extracting all the potential reserves of oil and gas mixed in with the geological strata beneath the surface.

This highly *competitive* situation had an extremely positive impact on oil production in Brazil. In terms of onshore and offshore production, the total rose from *306* million barrels in 1997 to *712* million in 2009.[25] Proven reserves[26], in turn, leapt from *7.1* billion barrels in 1997 to *12.8* billion barrels in 2009.[27]

In spite of the dizzying rise in oil reserves and production under the competitive regime introduced by the Oil Law, the discovery of the pre-salt[28] and the political opportunism which treated it as a catalyst for every imaginable boon to national development[29] started a shift to a change in the legal regime for exploration, culminating in the enactment of the Production Sharing Law in 2010.

3.2 The issue after the Production Sharing Law (2010)

Making production-sharing mandatory in the pre-salt areas,[30] the LPP defined it[31] as a regime for the exploration and production of oil, natural

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[25] AGÊNCIA NACIONAL DO PETRÓLEO, GÁS NATURAL E BIOCOMBUSTÍVEIS. *Anuário Estatístico 2010.* pg. 79 Available at: <www.anp.gov.br/wwwanp/publicacoes/anuario-estatistico/2435-anuario-estatistico-2010>. Accessed on: Jan. 16, 2017.

[26] Proven reserves are those that, based on an analysis of geological and engineering data, it is estimated can be recovered commercially from reserves that have been discovered and analyzed, with a high degree of certainty, where the estimate takes into account current economic conditions, generally viable operating methods and the regulations under Brazil's oil and tax laws. In 2014, Brazil was in 15th position in the world ranking of countries with the largest amount of proven oil reserves. AGÊNCIA NACIONAL DO PETRÓLEO, GÁS NATURAL E BIOCOMBUSTÍVEIS. *Anuário Estatístico 2016,* op. cit., pg. 72.

[27] Approximate figures. Cf., for exact figures, the source: Agência Nacional do Petróleo, Gás Natural e Biocombustíveis, *Anuário Estatístico 2010,* op. cit.; Agência Nacional do Petróleo, Gás Natural e Biocombustíveis, *Anuário Estatístico 2007,* op. cit.

[28] LPP

Article 2 For the purposes of this Law the following definitions shall apply:

[...]

IV — pre-salt area: region of the sub-soil formed by a vertical prism of indeterminate depth, with a polygonal surface defined by the geographical coordinates of its vertices established in the Appendix to this Law, and other regions delimited by act of the Executive, according to the evolution of geological knowledge; [...].

[29] FÓRUM NACIONAL. *Proposta do governo Lula de novo modelo de exploração do pré-sal.* Fórum Nacional: Rio de Janeiro, 2009.

[30] LPP

Article 3 The exploration and production of oil, natural gas and other fluid hydrocarbons in the pre-salt area and strategic areas shall be contracted by the federal government under a production-sharing regime as described in this law.

[31] LPP, article 2, I.

gas and other fluid hydrocarbons under which the contractor, at its own risk, explores, analyzes, develops and produces and, in cases of commercial discovery, acquires the right to appropriate the *cost in oil,*[32] the *volume of production corresponding to the royalties*[33] payable, and a portion of the *surplus in oil,*[34] in the proportion and on the terms and deadlines determined by contract. This concept immediately reveals a fundamental difference between the legal regimes of the LP and of the LPP: *under a production-sharing system, the Federal Government no longer receives a special participation and becomes the owner of part of the oil*[35] *extracted.*

In fact, the *special participations* are a significant component of the remuneration of the State under the LP for the exploration and production of oil in cases of *significant volume or profitability*[36] — such as the pre-salt areas.

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[32] LPP

Article 2 [...]:

[...]

II — cost in oil: portion of the production of oil, natural gas and other fluid hydrocarbons, which can be demanded only in the case of a commercial find, corresponding to the costs and investments made by the contractor in undertaking the activities of exploration, analysis, development, production and deactivation of the facilities, subject to the limits, deadlines and conditions established by contract; [...].

[33] LPP

Article 2 (...):

(...)

XIII — royalties: financial compensation payable to the states, the Federal District and the municipalities, and to direct government administration bodies, for the production of oil, natural gas and other fluid hydrocarbons under the production-sharing regime, pursuant to paragraph 1 of article 20 of the Federal Constitution.

[34] LPP

Article 2 [...]:

(...)

III — surplus in oil: portion of the production of oil, natural gas and other fluid hydrocarbons to be shared between the federal government and the contractor, according to criteria defined by contract, resulting from the difference between the total volume of production and the portions relating to the cost in oil, the royalties payable and, when required, the participation referred to in article 43; [...].

[35] From now on, for the purposes of literary flow, whenever I mention *oil* I shall be referring to the three elements: "oil, natural gas and other fluid hydrocarbons".

[36] LP

Article 50. The invitation to bid and the contract shall determine that in cases of large production volumes or significant profitability, a special participation shall be paid, as regulated in a decree issued by the President of the Republic.

paragraph 1 The special participation shall be applied on gross production revenues, minus royalties, the investment in exploration, operating costs, depreciation and tax at current rates.

[...].

Treated as extraordinary financial compensation,[37] *the rates are progressive and can reach 40% of net revenues from the quarterly production of each field.*[38]

In spite of this far from modest percentage, the government has exchanged the special participations of the LP for the ownership of oil under the LPP. With this remuneration in kind, the government shares the so-called *surplus in oil*[39] with the contractor company, receiving a percentage of the oil extracted.[40] There were no *qualitative* changes between the legal regimes in respect of the

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[37] Presidential Decree No. 2.705/1998

Article 21. The special participation provided for in section III of article 45 of Law No. 9.478, of 1997, established extraordinary financial compensation for oil and natural gas exploration and production concessionaires in cases of large production volume or significant profitability, in line with the criteria defined in this Decree, which shall be paid for each field of a given concession area as from the quarter in which production starts.

[38] Presidential Decree No. 2.705/1998

Article 22. To calculate the special participation on oil and natural gas production, progressive rates shall be applied on net revenues for the quarterly production of each field, minus the deductions listed in paragraph 1 of article 50 of Law No. 9.478, of 1997, according to the location of the well, the number of years of production, and the confirmed volume of quarterly production.

[39] See legal definition in the above footnote (LPP, article 2, III).

[40] The minimum percentage is fixed by the CNPE or in the tender document, depending on whether or not there is direct contracting:

LPP

Article 9 The duties of the National Energy Policy Council (CNPE) defined by law include proposing to the President of the Republic's office:

[...]

IV — the technical and economic parameters for the production-sharing contracts;

[...]

Article 10. The responsibilities of the Ministry of Mines and Energy shall include:

[...]

III — proposing to the CNPE the following technical and economic parameters for the production-sharing contracts:

a) the criteria for defining the federal government's surplus in oil;

b) the minimum percentage for the federal government's surplus in oil;

[...]

Article 12. The CNPE shall propose to the President of the Republic the cases in which, with a view to preserving the national interest and meeting the other objectives of the energy policy, Petrobras shall be contracted directly by the federal government to explore and produce oil, natural gas and other fluid hydrocarbons under the production-sharing regime.

[...]

Article 15. The invitation to bid shall include a basic draft of the respective contract and must indicate:

[...]

III - the minimum percentage for the federal government's surplus in oil; [...].

other financial elements of the concession in favor of the government, since both[41] include a *sign on bonus*[42] and *royalties*.

Another change under the LPP was in the area of management of the administrative contracts, between the State and the players in the IPGN, which was now handled by Pré-sal Petróleo S.A. (PPSA),[43] incorporated in 2013.[44] In addition to managing, PPSA is legally bound to associate itself

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41 LP

Article 45. The concession shall give details of the following government participations provided for in the tender document:

I — sign on bonus;

II — royalties;

[...].

LPP

Article 42. The production-sharing regime shall include the following government revenues:

I — royalties; and

II — sign on bonus.

[...].

For a comprehensive idea of government participations, see NASCIMENTO, Arthur Bernardo Maia do et al. Participações governamentais nos contratos de concessão de exploração e produção de petróleo e gás natural. *RBDP,* Rio de Janeiro, n. 2, pg. 111-147, 2006- 2009.

42 LPP

Article 2 [...]:

[...]

XII — sign on bonus: fixed sum payable to the federal government by the contractor on signing a production-sharing agreement and in accordance with its terms; and

[...].

43 LPP

Article 8 The federal government, through the Ministry of Mines and Energy, shall execute the production-sharing contracts:

[...]

paragraph 1 The contracts mentioned in the main section shall be managed by a public company to be incorporated for the purpose.

[...].

Concerning the PPSA and the changes to it in the regulatory environment of the IPGN, see RIBEIRO, Marilda Rosado de Sá. *Direito do petróleo.* 3rd ed. Rio de Janeiro: Renovar, 2014. pg. 492-499; SILVA, Ana Marília Dutra Ferreira da; GUEDES, Marina de Carvalho. A análise das motivações da instituição da PPSA em face da ANP: uma abordagem dos princípios da eficiência e legalidade. In: XAVIER, Yanko Marcius de Alencar et al. (Org.). *Direito do petróleo, gás natural e biocombustíveis:* estudos em homenagem à professora Helenice Vital. Natal: EDUFRN, 2013. pg. 41-62; LUNA, Priscilla Maria Coutinho Medeiros de. *As competências da Agência Nacional do Petróleo, Gás Natural e Biocombustíveis e o novo marco regulatório do pré-sal.* Monograph (bachelor degree) — Universidade Federal do Rio Grande do Norte, Natal, 2015. pg. 61-75.

44 Presidential Decree No. 8.063/2013.

with any company contracted to explore pre-salt areas[45] with the status of representative of the interests of the State, with an assured participation in the operating committee managing the consortium.[46]

Since I published my first *notes*,[47] I have been warning of the risks of political meddling caused by the creation of yet another public company related to the IPGN. At the time, I argued that the adoption of a production-sharing model was highly likely to increase the bureaucracy of the sector by incorporating a company that could be used as a flagship for political appointments of questionable merit. The PPSA came into being, and unsurprisingly, both its board of directors and its executive board are exclusively staffed with people *in the confidence* of the President of the Republic, as recommended by the top tier of government.[48]

On top of the change in the manner of remuneration of the Federal Government and the management of the contracts, the LPP introduced significant control over the subjective freedom to contract of the Brazilian State. Under the production-sharing regime, the State was now obliged to

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45 LPP, articles. 19 and 20.

46 LPP, articles. 21 and 23.

47 LEITE, Marcelo Lauar. Apontamentos sobre a regulação estatal nas areas de pré-sal. *Revista Jurídica In Verbis*, Natal, yr. 14, v. 25, pg. 53-64, Jan./Jun. 2009. pg. 60-63.

48 Bylaws of PPSA

Article 19. The board of directors shall consists of five members, appointed by the President of the Republic from a list of Brazilians of outstanding knowledge and experience, moral uprightness and untarnished reputation, as follows:

I — one member nominated by the Ministry of Mines and Energy, who shall chair the board;

II — one member nominated by the Ministry of Finance;

III — one member nominated by the Ministry of Planning, Budget and Management;

IV — one member nominated by the Chief of Staff to the President of the Republic; and

V — the Chief Executive Officer of PPSA.

[...]

Article 22. The Executive Board of PPSA shall be made up as follows:

I — Chief Executive Officer;

II — Contract Management Office;

III — Technical and Supervision Office; and

IV —Administration, Control and Finance Office.

paragraph 1 Members of the Executive Board shall be individuals resident in Brazil, with an untarnished reputation, moral uprightness, technical skills compatible with the position, and outstanding knowledge including corporate governance practices.

paragraph 2 All the officers and the Chief Executive Officer of PPSA shall be nominated by the President of Republic, on the recommendation of the Minister of State of Mines and Energy. [...].

contract Petrobras as *operator of all the blocks,*[49] either on its own or with a minimum interest of 30% in possible joint ventures.[50]

A priori, the obligation to contract Petrobras as operator of all the blocks could suggest the introduction of a typical *anticompetitive* regulation. In fact, this model of exclusivity was insistently defended by the then Minister of Mines and Energy, Edison Lobão,[51] as well as by Petrobras itself, based on the political and economic circumstances at the time.[52]

However it does not seem technically accurate to classify the regime enacted under the LPP in this category. In fact, the LPP was always accompanied by an undeniable competitive element, since in parallel to the regime of *direct contracting,* there was always a possibility of arranging a *bidding process in the form of an auction*[53] — although necessarily in partnership with Petrobras. It is not an exaggeration to say that the legislative format of the LPP suggests that putting the exploration of the pre-salt areas out to tender would be an exceptional *rule* for *direct contracting* in cases of "preservation of

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[49] LPP

Article 2 [...]:

[...]

VI - operator: the person responsible for directly or indirectly managing and executing all the activities of exploration, analysis, development, production and deactivation of exploration and production facilities; [...].

[50] LPP

Article 4 Petrobras shall be the operator of all the blocks contracted under the production-sharing regime, and shall be guaranteed for the purpose a minimum participation in the consortium provided for in article 20.

[...]

Article 10. The responsibilities of the Ministry of Mines and Energy shall include:

[...]

III — proposing to the CNPE the following technical and economic parameters for the production-sharing contracts;

[...]

c) the minimum participation of Petrobras in the consortium provided for in article 20, which may not be less than 30% (thirty percent); [...].

[51] Particularly in his first tenure, from January 21, 2008 to March 31, 2010. O SENADO NA MÍDIA. *Ministro quer adotar modelo de partilha da produção de petróleo.* Available at: <www.senado.gov.br/sf/noticia/senamidia/principaisJornais/notSenamidia.asp?ud=20080627&datNoticia=20080627&codNoticia=284825&nomeParlamentar=Aloizio+Mercadante&nomeJornal=Valor+Econ%F4mico&codParlamentar=845&tipPagina=1>. Accessed on: Sep. 8, 2008. For a defense of this model in the doctrine, see BERCOVICI, Gilberto. *Direito econômico do petróleo e dos recursos naturais.* São Paulo: Quartier Latin, 2011. pg. 322-324.

[52] FOLHA ONLINE. *Petrobras defende contratos de partilha de produção para o pré-sal.* Available at: <www1.folha.uol.com.br/folha/dinheiro/ult91u408359.shtml>. Accessed on: Sep. 10, 2008.

[53] Article 8, II.

the national interest" and fulfilling the other "objectives of the energy policy". This is because, while handling the bidding process is a *general duty* of the ANP,[54] direct contracting requires a *proposition* by the CNPE[55] in *specific* cases. In spite of this legislative panorama, the fact is that *only one Production Sharing RL was held in the first five years after the LPP was enacted.* The bidding round was held in 2013, putting on offer just the Libra Block,[56] in the Santos basin. At the time, 11 bidders qualified to submit offers.[57]

In view of this, my opinion is that *the model introduced by the LPP cannot be classified as anti-competitive or competitive, but is a hybrid regime with a mixed regulatory makeup.*

3.2.1 Subjective easing of production sharing under Law No. 13.365/2016

The third and most recent wave affecting the regulation of the pre-salt areas was Law No. 13.365/2016, which amended the LPP and *relaxed the obligation for Petrobras to act as operator of the pre-salt areas,* which until then had been the case both for direct contracts and tenders.

This subjective easing depends on a new definition of the term *"operator"*. Previously, the LPP identified it with Petrobras itself; now, it is amended to mean, in generic terms, "the person responsible for directly or indirectly managing and executing all the activities of exploration, analysis, development, production and deactivation of exploration and production facilities" (article 2, VI).

In this new context, Petrobras's role changes from one of *obligatory operation and participation* to a *preemptive right to operate* the exploratory blocks located in the pre-salt areas. This prerogative will be offered to it by the CNPE, taking the national interest into account, and the company must indicate its decision, giving reasons for *accepting* or *refusing*.[58] If the decision is to accept,

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54 LP, Article 8.

55 Article 12, main section, op. cit.

56 Sector SS-AUP1, with an area of 1,547.76 km^2.

57 CNOOC International, CNPC International, Ecopetrol, Mitsui & Co., ONGC Videsh, Petrogal Brasil, Petrobras, Petronas Carigali SDN, Repsol Sinopec Brasil, Shell and Total.

58 Article 4 The National Energy Policy Council (CNPE), considering the national interest, shall offer Petrobras first refusal to be the operator of the blocks to be contracted under a production-sharing regime.

"the CNPE shall propose to the President of the Republic's office which blocks should be operated by the company and indicate its minimum participation in the consortium".[59]

4. Subjective easing in the new regulatory model

As we have seen, subjective easing leads to uncertainty about the operation by Petrobras of future blocks located in the pre-salt. However the amendments to the LPP introduced by Law No. 13.365/2016 went beyond state (dis)intervention on the condition of *operation,* creating new perspectives, also related to the company's participation in joint ventures.

To say it another way, from now on there is no requirement for Petrobras to operate or even to participate in consortia for oil exploration in pre-salt areas. If it does operate them, its participation will be defined by the CNPE as at least 30% of the consortium (LPP, article 4, paragraph 2;[60] article 9, VIII and IX[61]). Thus there are a number of combinations of possible results, which are summarized in the following table:

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paragraph 1 Petrobras must indicate its interest or otherwise in the preemptive rights for each of the blocks offered, within thirty (30) days from notification by the CNPE, giving its reasons. [...].

59 LPP

Article 4. [...].

[...]

paragraph 2 After Petrobras has indicated its decision, the CNPE shall propose to the President of the Republic's office which blocks should be operated by the company, indicating its minimum participation in the consortium as provided for in article 20, which may not be less than thirty percent (30%).

60 Op. cit.

61 Article 9 The duties of the National Energy Policy Council (CNPE) defined by law include proposing to the President of the Republic's office:

[...]

VIII — the indication of Petrobras as operator, pursuant to article 4;

IX — the minimum participation of Petrobras if it is indicated as operator, pursuant to article 4.

[...].

DOES PETROBRAS WANT TO OPERATE?	% DESIRED	RESULT
✓	100%	Government can contract it directly or issue a hold a bidding process guaranteeing it a minimum participation of 30% (LPP, article 4, paragraph 2).
✓	= or > than 30% and <than 100%	Government can hold a bidding process guaranteeing it a minimum participation of 30% (LPP, article 4, paragraph 2).
✓	< than 30%	Inapplicable, expressly prohibited by law (LPP, article 4, paragraph 2).
✘	Any	Government can hold a bidding process, without any guarantee that Petrobras will participate as a non-operating member of a future consortium.

And so we have unavoidable echoes of *Popperian theory*. First of all, we have to ask whether or not a positive claim by Petrobras of its preemptive rights is binding on the government, as to accepting the company as operator.

The answer is No.

In fact, if consulted about the exercise of its preemptive rights, Petrobras has to *justify* its acceptance or refusal. With this legal imposition, the company has to *demonstrate to the government that there are valid reasons* for its decision. However, there are no objective legal benchmarks to link justification *X* to conduct *Y* on the part of the federal government. Now, *if this was classified as an administrative submission to the CNPE, there would be no mention of justification, but simply of manifestation.* It is undeniable, therefore, that *we are dealing with a discretionary choice on the part of the government.*

So we have to ask what would happen if Petrobras wanted to operate a certain area of the pre-salt on a non-exclusive basis, but with a participation of *more than* 30%.

To illustrate this, let us say that, consulted by the CNPE (LPP, article 4, main section), the company reacted positively and asked for a participation of 60% in the exploration of a block located in the pre-salt area. In the previous table, we saw that the result of this scenario is that the government can issue

a tender guaranteeing Petrobras a *minimum participation of 30%.* So we must ask: does the government have discretion to offer Petrobras an operation with 30, 60 or 90% of the future consortium?

The answer must certainly be No. If Petrobras, having preemptive rights for exclusive operation, indicates that it will *accept only* 60%, this means that it has tacitly *rejected* any operation higher than this percentage, which could be in clear contradiction of its investment policy or current financial capacity. So the government would not be expected to impose on it an operation covering an area more than requested, or instead of talking about *preemptive rights,* we would have to call it *duty to bear an imposition,* which would be contrary to the subjective easing introduced by Law No. 13.365/2016.

In an intermediate case, the question is whether Petrobras's preemptive rights can be exercised partially. Clearly if Petrobras can apply to operate an entire block in the pre-salt area, it can also ask for part of one. The question goes back to the government's discretion. In the same way as the State would be able to accept full operation by the company — contracting it directly if it indicated an interest in full operation —, it could also approve a partial operation in the same percentage as was requested by the company, depending on its criteria of convenience and opportunity.

The first scenario is more complex. If Petrobras wished to exercise its preemptive rights for 60%, could the government give it only 30? From what we have said so far, the answer would be yes: the government has discretion to differ from the company's justification for an operation on the proposed scale, even if accepting it for a lower percentage.

But is must be remembered that *the consultation/justification/decision process is purely pre-contractual.* So if Petrobras asks for an operating participation of 60% and the government, analyzing the justification, determines to give it 30, 40 or 50%, *the immediate consequence is that the company is no longer bound by its offer*[62] — even if negotiations are significantly facilitated by government appointees on its board of directors.

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[62] Federal Law No. 8.666/1993.

Article 54. The administrative contracts referred to in this law are regulated by their terms and conditions and by the precepts of public law, and are also subject to the principles of the general theory of contracts and the provisions of private law.

C*ivil Code*

Article 431. Late acceptance, or acceptance with additions, restrictions, or modifications, shall imply a new proposal.

One obvious response to these preliminary thoughts is that no conflicts of this nature would arise, since Petrobras, as a state company, would always align its interest with the desires of the government. I reject this outright. Even though the government has the power to appoint a majority of the company's board of directors, it must be said that this is due to its history of shareholder control, which can be changed by a simple amendment to the law.[63]

Although this issue has not been (seriously) brought to the fore, the need to capitalize the company after its involvement in successive cases of corruption could serve as a catalyst in a possible process of dissolution of its power of control in the market. One can get an idea of this from the fact that at the height of the accusations against the company during *Operation Carwash (Lava Jato),* its market value shrank by 85% from its peak in 2008,[64] and as a result it had to dispose of a series of assets at bargain prices.[65] In the two-year period 2017-18, Petrobras is planning to sell more assets to the value of almost *20 billion dollars.*[66]

Unless there is any change in the shareholding structure — in other words, if the State retains control of the company —, the fact is that the panorama post-Lava Jato forced Petrobras to design and implement a number of new strategies for corporate governance and compliance, such as: *(i)* a due diligence process for contracting mechanisms; *(ii)* independence also for *internal* audits; *(iii)* internal commissions of enquiry; *(iv)* a new whistleblowing channel; and *(v)* application of disciplinary measures. In this new context, the managers of Petrobras — board members and officers — hold more responsibility for decision-making, and are expected to consider the interests of the company when these conflict with those of the government.

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63 LP

Article 62. The federal government shall maintain shareholder control of Petrobras with ownership and possession of at least fifty percent of the shares plus one share, of the voting capital.

[...].

64 G1. Petrobras encolheu 85% em, valor de Mercado desde pico de 2008. Available at: <http://g1.globo.com/economia/noticia/2016/01/petrobras-encolheu-85-em-valor-de-mercado-desde-pico-de-2008.html>. Accessed on: Jan. 30, 2017.

65 VALOR ECONÔMICO. Petrobras atinge 87% da meta de desinvestimento para biénio 2015-2016. Available at: <www.valor.com.br/empresas/4815283/petrobras-atinge-87-da-meta-de-desinvestimento-para-bienio-2015-2016>. Accessed on: Jan. 30, 2017.

66 PETROBRAS. Operação Lava Jato: para continuar seguindo em frente, estamos empenhados em esclarecer os fatos e supercar nossos obstáculos com trabalho e resultados. Available at: <http://lavajato.hotsitespetrobras.com.br>. Accessed on: Jan. 30, 2017.

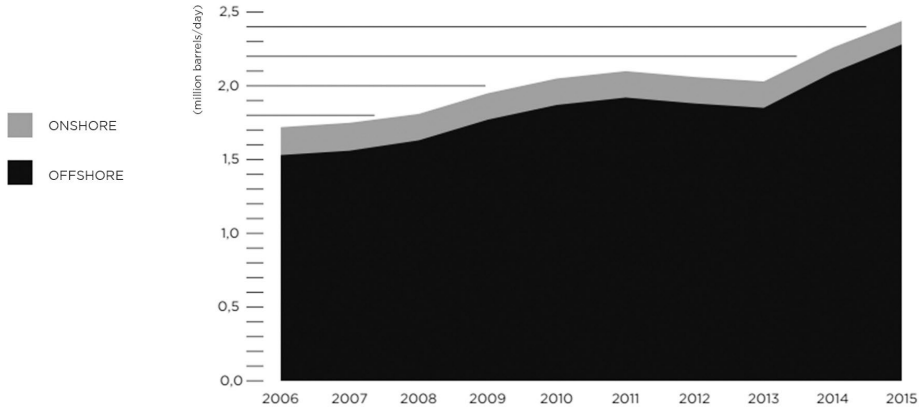
5. Some final thoughts: will the changes in the LPP be advantages?

The latest changes in the legal regime for the pre-salt areas are intended to improve the indices of exploratory development and, with them, all the indirect repercussions — tax, technology, jobs etc. Will it work?

Ideological debates aside, it makes sense to wager that it will. An analysis of the figures for the last five years demonstrates the failure of the exploration model which imposed on Petrobras the obligation to operate the pre-salt areas.

Earlier we saw the positive impact of the Oil Law on the production of oil in Brazil. To repeat what I wrote then, "in terms of onshore and offshore production, the total rose from *306* million barrels in 1997 to *712* million in 2009. Proven reserves, in turn, leapt from *7.1* billion barrels in 1997 to *12.8* billion barrels in 2009".

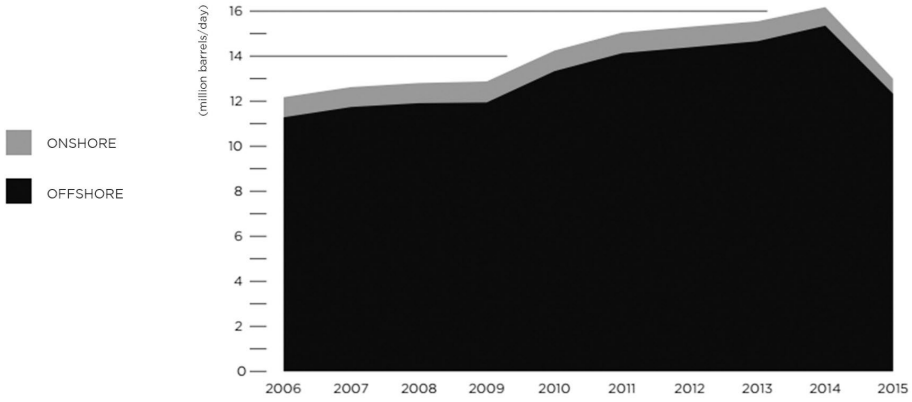
While the LPP was in force, the figures for oil exploration in Brazil were lamentable. From 2010 to 2013, onshore and offshore production remained static at around *750* million barrels per year. Only in 2014 was there an improvement, and the total was *889* million in 2015.[67] For this production from the pre-salt areas was decisive — "by chance", after the first (and, so far, the only) production-sharing RL, as the following chart shows.



Source: ANP.[68]

[67] Agência Nacional do Petróleo, Gás Natural e Biocombustíveis, *Anuário Estatístico 2016*, op. cit. pg. 80.
[68] Ibid., pg. 82.

As to proven reserves, the country achieved the "prowess" of ending 2015 with the total unchanged since 2009: we still had *12.9* billion barrels.[69] Here it is:



Source: ANP.[70]

The figures show that no regulatory model was better for the development of Brazil's oil potential than the *pro-competition* model under the Oil Law. For its provisions to be applied to the exploration of the pre-salt areas, it would be enough to increase government participations, which would encourage other players to enter the market, bringing all their indirect benefits — the creation of cheaper and more efficient technology, jobs, demand for services and the circulation of wealth in general. And on top of this the State would be spared the expense of investing National Treasury resources in companies like PPSA.

This is my personal opinion, but one has to look at the current scenario. If we accept its assumptions, the amendments to the LPP at the end of 2016, although not reviving the LP model, have the potential to improve the results of exploration of the pre-salt areas. In this way, Petrobras could finally be rid of the obligation to operate or participate in activities for which — as time has shown — it has neither capacity nor interest.

[69] Ibid., pg. 73.
[70] Ibid., pg. 73.

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