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Successful Pre-Salt Auctions Put Brazil's Oil & Gas Sector on Promising Path

EXECUTIVE SUMMARY

The oil and gas sector in Brazil is undergoing its most dramatic transformation since the founding of state-owned energy giant Petrobras in 1953. For the first time in history, the National Energy Policy Council (CNPE) has approved a bidding process to auction drilling rights to international oil and gas companies, creating a more competitive, market-oriented model. The success of the September 2017, 27 concession regime auctions and October 2017, 27 pre-salt auctions in Brazil reflects the successful regulatory changes the Brazilian government has implemented over the last year to open up the pre-salt region to foreign investment. Such reforms include the implementation of a multi-year transparent bidding process, more flexible local-content policies, and the abolishment of the mandatory requirement that Petrobras be the sole operator in pre-salt oil fields. In his first opportunity to publicly discuss the bidding rounds, Decio Oddone, Director-General of Brazil's National Petroleum, Natural Gas, and Biofuels Agency (ANP) outlined Brazil's potential to increase its productivity in the next few years. The next auctions, scheduled for March and June 2018, are expected to extend the positive trend and strengthen the nation's capacity to confront fiscal and structural challenges. Brazil is predicted to become the largest offshore market in the next four years as it continues to incentivize oil exploration and production.

Introduction: Ambassador Anthony Harrington, Chairman of the Brazil Institute Advisory Board

Speaker: Decio Fabrício Oddone da Costa, Director-General of Brazil's National Petroleum, Natural Gas, and Biofuels Agency (ANP)

Moderator: Paulo Sotero, Director, Brazil Institute

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4th Floor, Woodrow Wilson Center

In his opening remarks, **Paulo Sotero**, stated that Petrobras's previous monopoly over oil and gas fields is now being replaced by a competitive, market-oriented model as Brazil looks to attract international interest and investment. The National Petroleum, Natural Gas, and Biofuels Agency (ANP) has overseen this shift from privileging Petrobras as the sole operator to a system that encourages exploration and engagement by major international players in the oil and gas sector.

Ambassador Anthony Harrington, Chairman of the Brazil Institute Advisory Board, underscored the recent successes of this new model. On October 27, ANP conducted two successful auctions in offshore pre-salt fields. A dozen major oil and gas companies participated, generating over US\$ 6 billion in revenue: a testament to the success of an open and

diverse environment in the oil and gas sector. Harrington contended that this success would not have been possible without Pedro Parente, the CEO of Petrobras, who has played an important role in introducing business sense to the company.

Decio Oddone, Director-General of Brazil's National Petroleum, Natural Gas, and Biofuels Agency (ANP) began his remarks by stating that since Pedro Parente's speech at the Wilson Center on November 16, 2016, Brazil has made significant strides in developing its oil and gas sector through promoting exploration. When Petrobras was first founded in 1953, Brazil was a rural country with an economy based on agriculture. Over the last sixty years, however, Brazil has become a modern society, and the persistence of Petrobras's monopoly resulted in an underdeveloped oil and gas industry. In an effort to create a more developed industry, ANP seeks to expedite exploration and attract the right players in three different frontiers before the end of the oil era (i.e., before renewables become dominant in the energy market). These three areas are the Pre-Salt region, the Conventional Offshore region, and the Onshore basins.

Brazil's Pre-Salt region is home to the largest offshore oil discoveries in the last decade and represents about half of Brazil's reserves; however, Oddone argued that this high productivity does not fully represent the region's full potential and estimated there are billions of barrels yet to be converted into reserves. Due to the limited number of contracts in the Pre-Salt region, Oddone declared that the ultimate goal is to increase exploration in order to fully understand the region's

Decio Oddone speaks at opening ceremony for the 2nd and 3rd pre-salt deepwater bidding rounds on October 26, 2017 (image credit: Saulo Cruz/MME/Flickr)



Paulo Sotero (center) and Decio Oddone (right) at the Wilson Center on November 16, 2017



potential. ANP also seeks to attract major operators that specialize in developing new fields in order to speed up the process and provide the technology and resources needed to explore the Pre-Salt region's deep reservoirs.

Brazil's Conventional Offshore region consists of all the East Margin (excluding the pre-salt region) and the Equatorial Margin (located off the north and northeastern coasts of Brazil). Given that this region contains new frontier basins and exploratory opportunities in mature basins, Oddone indicated that the goal is to incentivize international investment in order to increase exploration. In addition, ANP aims to increase the production and recovery factors in mature basins, especially in the Campos Basin, to offset the 30 percent decrease in offshore production between 2010 and 2017. To accomplish this, Oddone said the sector needs to attract mature field players, in addition to major operators and exploration specialists.

The Onshore basins in Brazil consist of both mature and new frontier basins. Given the 30 percent decrease in onshore oil production, the 30 percent decrease in onshore oil reserves, and an 80 percent decrease in the number of development wells drilled in Onshore basins, Oddone conveyed the need to focus on revitalization activities in the Onshore region by attracting small and medium companies that have expertise in mature fields. He affirmed that there is a huge potential for recovery. Oddone also welcomed the idea of attracting exploration specialists to examine new frontier basins and unconventional regions, with the end goal of increasing exploration activities to stimulate natural gas exploration and make the industry more dynamic and competitive.

To facilitate international investment in these three regions, Oddone listed a series of measures that will attract new players. The abolishment of the mandatory requirement that Petrobras be the sole operator of pre-salt exploration is arguably the most critical measure that has led to a market-oriented model. In addition, the creation of a multi-year bidding rounds calendar will further encourage international investment; if bidding rounds continue, Oddone estimated that oil production could increase to 5-6 million barrels a day by 2027. Furthermore, an open acreage policy is estimated to boost recovery: starting in 2018, Oddone declared that companies will be able to study permanent blocks and make

specific auctions, which is predicted to benefit small and mid-sized companies that wish to invest in mature fields. Additional measures include the extension of an exploratory phase, improving local content regulations, and better integrating the financial environment with oil and gas sector.

If Brazil succeeds in implementing these measures and attracting the right actors, Oddone predicted that 39 new offshore production platforms would develop by 2030, generating about R\$ 845 billion (US\$ 265 billion) in revenue, which falls within the range of the government's fiscal deficit. Oddone emphasized the importance of attracting new players to mature fields, given that every 1 percent increase in recovery is equivalent to 2.2 billion barrels in additional reserves, which would result in US\$ 18 billion in new investments and US\$ 11 billion in royalties. Therefore, combined revenues from exploratory production and mature fields would produce revenues that are very relevant to the recovery of Brazil's economy.

In closing, Oddone expressed that the new regulatory measures should stimulate unprecedented growth in Brazil's oil and gas sector and open new opportunities for investment, completing the opening of the oil and gas sector that began in 1997 when Petrobras's monopoly formally ended. Oddone insisted that Brazil will see a new and improved oil and gas industry by 2020, and argued that the companies that invest now will be the winners in this revitalized market.



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