NEW PLAYERS IN OIL EXPLORATION AND PRODUCTION IN BRAZIL

The petroleum industry worldwide has been undergoing profound changes over the last few years, due to the gradual elimination of national borders for oil and natural gas exploration and production (E&P).

An ever-larger number of countries has been advancing institutional change in the administration of their oil industries, seeking to allow the entry of foreign capital. As such, E&P activities, once exclusively controlled by both state-owned and private national companies, are now being developed by foreign companies.

Among the significant oil producing countries, only Mexico and Saudi Arabia have yet to open their exploration and production industries to foreign players, with even foreign involvement prohibited in partnerships and the granting of concessions or licenses to research and develop reserves in specific areas. Some of the more important markets recently opened to foreign participation are the countries of Eastern Europe, India, China, and various countries in Latin America.

OIL AND NATURAL GAS EXPLORATION AND PRODUCTION
MARKET LIBERALIZATION

MARKETS
- Non-Producer
- Closed
- Open
- Recently Opened

Source: UK Offshore Operators Association (UKOOA)

Within this context, Brazil – in step with other countries in the Southern Cone – has been seeking to foster the development of its oil industry by attracting international investors. Although this liberalization occurred in parallel with the opening of other sectors characterized by strong participation by the state, the opening of Brazil’s oil industry adhered to a particular strategy. The productive chain in the industry was, in practice, in the hands of a single company, Petrobrás, and this factor was crucial in determining the way in
which competition was introduced. The first step was the dismantling of the monopoly by Constitutional Amendment No. 9, and the subsequent regulation of the sector by Law No. 9,478 of August 6, 1997 (known as the Petroleum Law). Next, the regulatory framework for each segment of the industry was created.

In compliance with the Petroleum Law, in July 1998 the Brazilian Petroleum Agency (ANP) announced the exploration and production areas that would be granted to Petrobrás and those that would between placed under the tutelage of the government to be granted as concessions in future auctions. As a result, the ANP retained 92.9% of the total area of Brazil’s 26 sedimentary basins, and Petrobrás remained with only 7.1%.

One year after the splitting of the concession areas, the ANP began the tender offer process for the areas that remained under its control. The first round of auction took place in June 1999, the second in June 2000, and the ANP is planning a new round of auctions for 2001.

In October 1998, Petrobrás, as part of its new strategy, signed the first contract for a partnership with other players for oil exploration and production in its concession areas. Since then, the number of partnerships signed to end-July 2000 totaled 36, for total investment of the order of US$ 3.6 billion.

In the two auctions held by the ANP, 50 exploration and production areas were sold, a total of 191,447.2 km², corresponding to 3.2% of the sedimentary basins under the agency’s control.

The sector now has 40 new players, taking into account the results of the first two auctions and the partnerships already contracted by Petrobrás (see attached table). Out of these 40, the vast majority (34) are foreign companies, of which 15 are from the United States.

An important factor is the gradual entry of Brazilian companies in the market, especially those that already operated in the industry before the breakup of the monopoly by providing services to Petrobrás, such as Queiroz Galvão, Odebrecht and Marítima/Rainier.

**ANP AUCTIONS**

In order to influence the auction’s results and, especially, to influence the profile of the participants, the two auctions held by the ANP featured very different characteristics. For example, the ANP reduced minimum requirements for financial qualification of companies in the second auction as a way of expanding the spectrum of competitors, with minimum stockholders’ equity for qualification falling from US$ 10 million in the first auction to US$ 1 million in the second auction. Another difference was that in the first auction, the blocks offered were primarily deep sea areas (63%), while in the second auction, deep sea and shallow sea areas were more or less equal (30% and 26%, respectively). In the first auction, only four land-based areas were offered, equivalent to 15% of the blocks offered, while in the second auction land areas totaled 44% of the area offered. In addition, in the first auction, the total area offered totaled 132,176 km², or an average of 4,895 km² per block, compared to the total area offered of 59,271 km², or an average of 2,577 km² per block, in the second auction.

The total of minimum required investments in the two auctions also differed substantially: US$ 200 million in the first auction, falling to US$ 63 million in the second auction, bringing the total minimum investment requirement of all of the exploration areas sold in the two auctions to US$ 263 million. However, taking into account only the areas sold at auction, the minimum investment requirement was US$ 123 million (US$ 65 million from the first auction and US$ 58 million from the second).

Another important indicator is the level of commitments of purchase of goods and services, which in the second auction totaled an average of 41.8% and 47.9% for exploration and development, respectively, while in the first auction these figures were 25.4% and 26.7%, respectively.

Proceeds from the two auctions totaled R$ 790 million (US$ 439 million), with R$ 322 million from the first auction and R$ 468 million from the second auction. The ANP, which planned to receive R$ 4.5 million from the second auction (the sum of the minimum auction bids), ended up receiving almost 50%
more than in the first auction, representing a 10,306% premium over the minimum set auction amounts.

These results show the impact that the change in rules had on the results of the last auction.

**NEW PLAYERS**

In the first auction held in June 1999, the ANP offered 27 blocks, of which 12 (all offshore) were sold. No offers were placed for the remaining 15 blocks. Of the 23 blocks offered in the second auction, only two received no bids.

In both auctions, the blocks that received the greatest interest were located in the Santos and Campos basins, which together received 14 and 22 offers in the first and second auctions, respectively.

Analysis of the highest premiums placed at the auctions shows that the companies that risked the most were Petrobrás, Agip (ENI Spa Group), Shell, Chevron, British Gas and YPF which together were responsible for 80% of auction proceeds. The highest bid at the first auction was made by Agip for the block BMS-4, located in the Santos Basin, at a premium of 53,565% over the minimum set auction price. In the second auction, once again a block located in the Santos Basin (BMS-9) received the highest bid, from the Petrobrás/British Gas/YPF consortium, for a premium of 38,659% over the minimum auction price.

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**FIRST AUCTION**

<table>
<thead>
<tr>
<th>BLOCK</th>
<th>No. of bids</th>
<th>PROCEEDS (R$ MILLION)</th>
</tr>
</thead>
<tbody>
<tr>
<td>BMS-4</td>
<td>3</td>
<td>150</td>
</tr>
<tr>
<td>BMS-2</td>
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<td>120</td>
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<tr>
<td>BMS-3</td>
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<td>100</td>
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<tr>
<td>BMS-1</td>
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<td>80</td>
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**SECOND AUCTION**

<table>
<thead>
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<th>BLOCK</th>
<th>No. of bids</th>
<th>PROCEEDS (R$ MILLION)</th>
</tr>
</thead>
<tbody>
<tr>
<td>BMS-9</td>
<td>3</td>
<td>140</td>
</tr>
<tr>
<td>BMS-10</td>
<td>5</td>
<td>120</td>
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<tr>
<td>BMS-11</td>
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<td>100</td>
</tr>
<tr>
<td>BMS-8</td>
<td>3</td>
<td>80</td>
</tr>
</tbody>
</table>

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Analysis of results shows that after the auction, in addition to Petrobrás, 22 companies, either individually or in consortiums, shared oil exploration and production activities in Brazil.

In the first auction, the winning bids for the 12 blocks sold were placed by Petrobrás and 10 international companies, which included leading companies, such as Exxon Mobil, Royal Dutch/Shell, BP Amoco Arco, Texaco and ENI. Petrobrás placed five winning bids (more than any other company), one individually and the other four in partnership with other companies. Among the most aggressive foreign companies were Agip (Italy) and YPF (Argentina), which each placed four winning bids, and Texaco and Exxon, which placed three and two winning bids, respectively.

The only Brazilian company to participate in the first auction was Petrobrás, which was mainly due to the high level of financial requirements of the tender offer.

As mentioned above, the second auction included a greater number and diversity of participants. In contrast to the first auction, the second auction included the participation of medium-sized international companies and even Brazilian companies other than Petrobrás.

Petrobrás’s participation in the second auction was more intense, with the company placing the winning bid for eight companies, five of which were located in the Santos Basin. The company will also be the operator in seven out of the eight blocks; only in one of the blocks acquired in the Santos Basin is Petrobrás’s participation via a consortium, in which Chevron will be the operator. Petrobrás’s interest in blocks located in the Santos Basin is due to the company’s vast knowledge of the region’s potential, following last year’s discovery of a giant field with reserves estimated at some 700 million barrels of oil.

The four other Brazilian companies that placed winning bids in the second auction were Ipiranga, Maritima/Rainier, Queiroz Galvão and Odebrecht.
In the second auction, 11 foreign companies participated. In contrast to the first auction, the participation of the “oil giants” was somewhat limited, with only Shell (acting alone) acquiring a block in the Campos Basin, and (in partnership with Petrobrás and Petrogal) a block in the Santos area. The strongest showing in the second auction by a foreign company was placed by the U.S. company Coastal, which acting alone acquired the right to develop three areas, one located on land in the Paraná Basin, and the other located offshore, in Camamu-Almada and Pará-Maranhão.

PETROBRÁS PARTNERSHIPS

Another form by which new players are increasingly entering the Brazilian oil industry is through partnerships created with Petrobrás for investments in E&P in the blocks under the company’s control.

Since the signing of Petrobrás’s first partnership for the exploration of Block BES-3 in Espírito Santo, 35 other contracts have been signed (see attached table). In all, Petrobrás’s partnerships have involved 32 companies, of which five are Brazilian: Petroserv, Sotep, Ipiranga, Queiroz Galvão and Odebrecht. Among the foreign companies involved, the U.S. company Unocal has signed the most contracts with Petrobrás (11 blocks), followed by the U.S. company El Paso/Coastal, which signed partnerships in nine blocks.

The majority of contracts (26) were for projects for exploration (the upstream phase with the greatest risk), representing investments of almost US$ 1 billion. The remaining partnerships were for production (2), and development and production (8), for total investment of US$ 2.6 billion. The Campos and Potiguar basins were the areas in which Petrobrás most adopted the partnership model (17 projects).

Another type of joint venture that Petrobrás is beginning to develop is exchange of asset projects, in which the company expands its activities outside of Brazil in exchange for assets held inside Brazil. A typical case is the operation currently being negotiated with Repsol/YPF, in which the company transfers to Petrobrás its chain of 800 gas stations and a refinery in Argentina, in exchange for the assumption of 300 BR Distribuidora gas stations and the acquisition of stakes in the Alberto Pasqualini Refinery (Refap) and the project to develop production in the Albacora Leste Field.

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1 Legislation in almost all nations holds that all petroleum resources found on their territories are the property of the state, and the economic development of these resources is always intermediated by contracts between the state, a government agency or a state-owned company, and private-sector companies of any nationality. At present, most contracts are of the following types: concession or license granting rights for the exploration or production at the investor’s risk, joint venture, joint production contract, contract to provide services.

2 Except for the distribution of petroleum byproducts, which was open to competition, Petrobrás held the monopoly on all other segments in the industry (exploration, production, transport, refining, importing and exporting).

3 The total area of Brazil’s sedimentary basins is 6,436,000 km².

4 The area corresponds to more than twice the landmass of Portugal.