

# The Changing Brazilian Natural Gas Regulatory Framework: A Veto Player Analysis

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# OUTLINE

## Introduction

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# INTRODUCTION – (1)

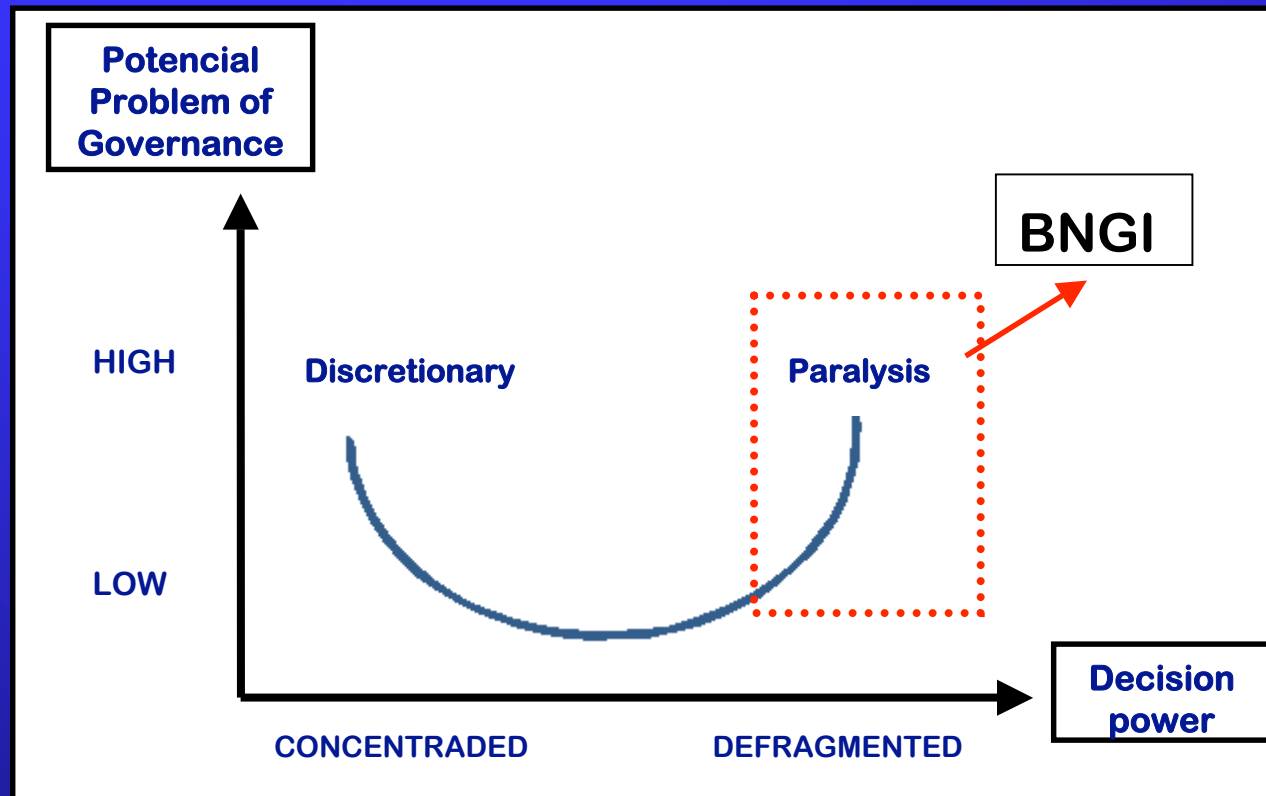
- General perception by almost all of the natural gas' actors that Brazilian current natural gas regulatory framework (Law 9.478/97) was inadequate.
  - Poor downstream regulation
  - Institutional conflicts and lack of planning
  - High investment risk
- This consensus did not helped to accelerate the political negotiation towards a new gas law
- Why?

# INTRODUCTION – (2)

- This paper tries to explain:
  - Why the political negotiation process for approving a new law took so long (5 years...).
  - Why very few changes has been introduced in natural gas regulation.
- Institutional Economic Theory, specifically on the Veto Players Model (Tsebelis, 2002; Glachant, 2002; Perez, 2004; and Glachant & Perez, 2007).

# THE VETO PLAYERS MODEL: MAIN IDEAS

Tsebelis (2002): “Veto players are individual or collective actors, who the agreement is needed in order to achieve the necessary consensus to change the current policies of the country”.



Source: Own elaboration, based on Glachant & Perez (2007)

# EVOLUTION OF THE REGULATORY FRAMEWORK

- Before 1988 – Petrobras was the only operator in all gas chain
- 1988 – Distribution becomes a State monopoly (state owned operators )
- 1995 – Privatization of distributions companies allowed
- 1997 – Oil and Gas Law: competition in the upstream and open-access to transportation infrastructure
- 2009 - New gas law

# VETO PLAYERS AND BARRIERS TOWARDS BEST PRACTICES IN BNGI

During the reform of the Brazilian NGI negotiation process, we can find out 6 main players or group of players:

- (1) the Federal Government represented by the Ministry of Mines and Energy,
- (2) Petrobras;
- (3) State Governments and/or local distribution companies (LDC);
- (4) National Oil and Gas Regulation – ANP;
- (5) Large industrial gas consumers; and
- (6) Private upstream operators.

Only Petrobras, MME and State governments and/ or LDC can be considered Veto players.

- They have been able to avoid any significant regulatory change that could harm their interests, by establishing pre-conditions for the negotiation process.

**Result:** After a lengthy negotiation process, it was approved a new law with few significant changes on the regulatory framework.

# POSITIONS OF BNG MAIN PLAYERS WITHIN ITS PROCESS OF NEGOCIATION

	MME	Petrobras	ANP	State Governments/LDCs	Large Consumers	Private upstream operators
Main Objectives	Strengthen and amplify the planning and intervention power	Maintain its market power and dominant position	Amplify its regulatory power and increase competition  Open access to the downstream	Maintain distribution monopoly  Increase upstream competition	Increase competition in the entire chain	Reduce entry barriers
Positions at the negotiation process	Tried to guarantee a central role in NGI planning investment dynamics	Tried to avoid big regulatory changes  Tried to ensure distribution by-pass for its own gas consumption  Tried to avoid open access to the gathering pipelines infrastructure	Tried to establish a concessions regime in transportation  Tried to increase its role on tariff regulation in transportation  Tried to increase its enforcement power	Tried to avoid physical and commercial by pass of the distribution companies;	Tried to create tariff regulation in transportation  Tried to increase open access to the network  Tried to implement physical and commercial by pass of the distribution companies	Tried to increase open access to the network  Tried to implement physical and commercial by pass of the distribution companies
Profits	Planning the sector expansion  Ability to determine investment in the transportation segment	Few changes in regulatory framework  Permanence of dominant position  Ability to by-pass distribution companies in case of self consumption	Concessions regime for new pipelines	Maintenance of distribution monopoly	Possibility to commercially by-pass distribution companies in case of gas imports for own consumption	Possibility to commercially by-pass distribution companies in case of self consumption
Losses	Not relevant	Not relevant	Enforcement remained low  Absence of tools to stimulate competition	By-pass of distribution companies in case of self consumption	Lack of competition	No reduction of entry barriers

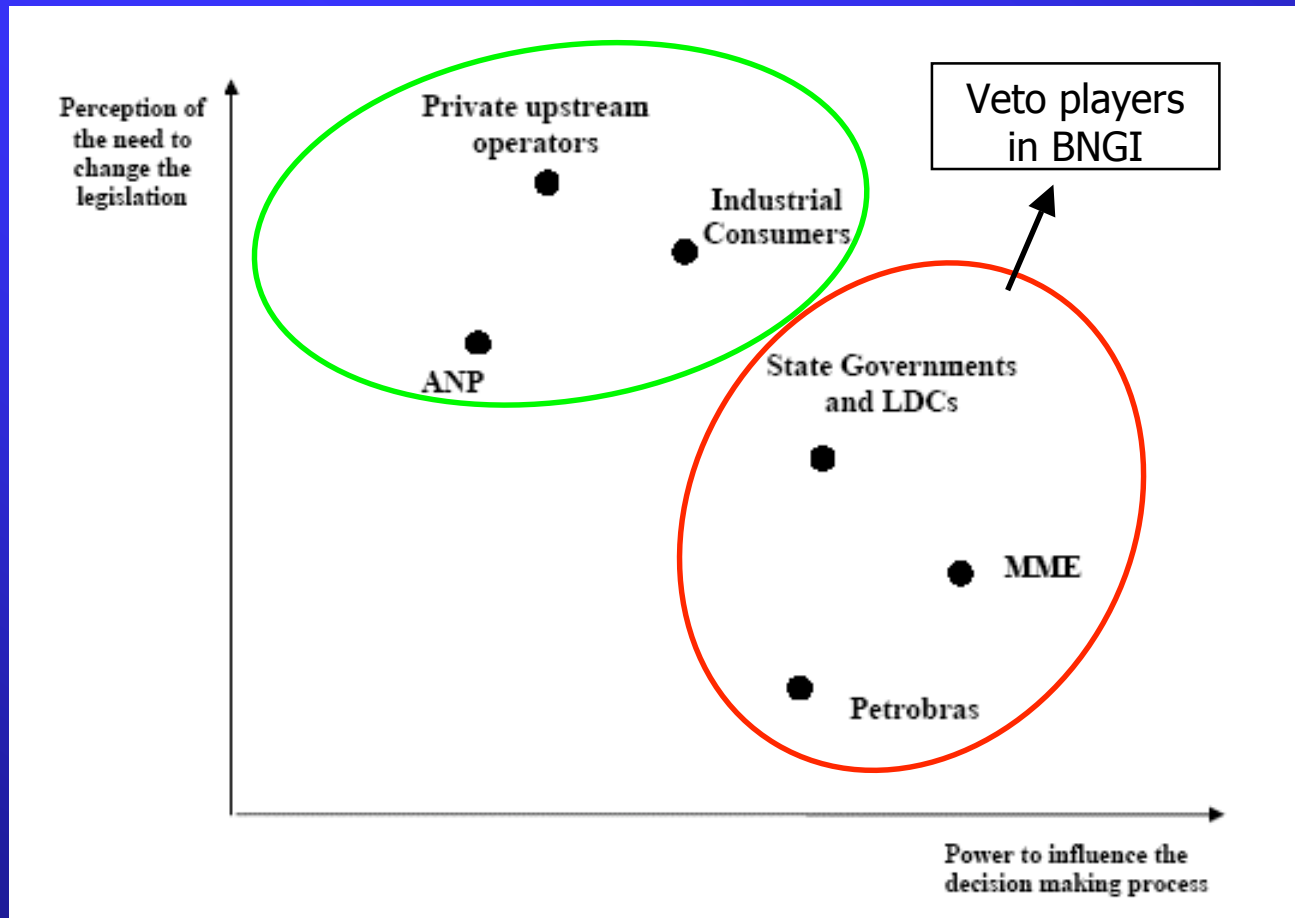
Source: Own Elaboration



Fonte: Elaboração própria

Grupo de Economia da Energia

# FIGURE 2 – MAIN PLAYERS IN THE BRAZILIAN NATURAL GAS INDUSTRY



Source: Own elaboration

Each of these players have different level of power to interfere in the decision making process and different perception of the need to change gas regulatory framework.

In the case of Brazilian NGI, players more committed to the reform were those with less power to interfere in the decision making process. This was the main reason why the negotiation process took so long to reach a consensus.

# MAIN CHANGES IN BRAZILIAN NEW GAS LAW

## NEW GAS LAW: MAIN CHANGES - 1

- Changes focused on the gas transportation, while the backbone of Law 9478/97 has been preserved
  - Upstream regulated by the 9.478/97 Law;
  - Gas Distribution remained out of Federal Gas regulation;
  - Current industry structure remained unchanged;
  - Petrobras remains the dominant actor in the production and importation of gas without any restrictions on cross-holdings along the gas chain, remaining free to decide the pricing of gas in Brazil.
  - The majority interpretation of Brazilian jurists in regards to the term "local services of piped gas" has been that all activities within the natural gas sector from the city-gate is the competence of each state, regardless of whether this activity can be consider to be known as a natural monopoly or not.

## NEW GAS LAW: MAIN CHANGES - 2

- **Concession x Authorization**
- It was defined the necessity to be organized an open-season process in order to ensure both the increase and building of new gas pipelines
- **Different Rules for the access for the new and the current transportation pipelines**
- **Shared responsibility for planning, regulation and monitoring of the gas transport system and for the establishment of emergency contingency plans**
  
- **Own consumption of Petrobras in its: oil refineries; fertilizer plants, and their platforms were considered out of the scope of the state monopoly distribution. This explicitly excluded all the gathering pipelines and the pipelines which transport gas from processing plants to the refineries of the requirements of free access after a exclusivity period**
  
- **Preservation of both contractual and industrial structures prior to the gas law**
  
- **Rules for defining the free consumers will be established by each state, and no longer by the 11.909/2009**
  
- **Responsibility to propose and adopt the necessary proceeding to restore transportation services in case of failure in the gas supply is left to CNPE**

# NEW GAS LAW: MAIN CHANGES - 3

## Planning

- MME will be responsible for planning and propose new projects to expand the transport system. MME will also define the main characteristics of the future pipeline projects:
  - ➔ Type of Grant
  - ➔ Participation or not in the public sector investment through PPP instrument
  - ➔ Use of public resources to finance or subsidize energy projects

## Projects Licensing through concession

- New transportation and storage in geological formations
  - ➔ MME performs plans including new projects and expansion of pipelines
  - ➔ ANP organize open concurso aberto to estimate potential demand
  - ➔ ANP organizes bids for choosing the investor, and shall be able to determine also the transportation tariffs of this contracts, instead of only mediate in disputes between the parties involved on it.
- Authorization will be an exception, while concession will be the general rule:
  - ➔ Existing pipelines, international pipelines, and the ones dedicated to specific consumers
  - ➔ Remaining infrastructure (gathering pipelines, transfer pipelines, Units of natural gas processing, LNG regasification terminals, LNG liquefaction plants, storage systems via LNG; and plants compression)

# NEW GAS LAW: MAIN CHANGES - 4

## Open access

- According to the new law, open access to transportation pipelines shall be ensured only after a period of exclusivity.
- Just after a exclusivity period:
  - Current transportation pipelines: 10 years, counted from the start of commercial operation.
  - New pipelines: Ministry of Mines and Energy will fix the exclusivity period.
- Law n. 11.909/2009 explicitly excludes all gathering pipelines and pipelines that transport gas between processing plants and refineries from the opens access requirements. Thus the Gas Law 11.909/2009 in Brazil preserved an important barrier to entry for new entrants in the upstream. But, why did it happened?
- A tip... Petrobras state explicitly in its Strategic Plan for the period 2009-2013 that the gas localized in the pre-salt area would be transported through gathering pipelines.

## NEW GAS LAW: MAIN CHANGES - 5

### Pipelines dedicated to great consumers

- Three types of large users have the right to build pipelines, only when the distributors are not able to build them, since they previously sign contracts for both operation and maintenance with the gas distribution companies:
  - Free Consumer
  - Auto-producer
  - Self-imported

## HOWEVER...

- At the inexistence of any restrictions on the cross-subsidies practice along the gas chain and by allowing the practice of commercial and physical by-pass, in the case of its own consumption, Brazilian Gas Law guaranteed to emerge significant high barriers to entry of both potential private operators and large consumers in the upstream segment.
- The maintenance of BNGL structure not only preserves the dominant role of Petrobras, but also allows it to adopt a strategy in the direction to expand its participation in the piped gas distribution activity. Nowadays, this participation has already reached around 40% of all domestic gas distribution.

## HOWEVER ... (CONT.)

- The creation of these three actors would not result in spontaneous increased of the competition along the gas chain, as the major consumers were aimed, nor have reduced the barriers to entry in this industry, which in turn harm the interests private operators of the upstream segment. It is necessary to be build both industrial and institutional structures more adequate, as well as financial incentives necessary for the development of BNGI.
- 11.909/2009 Law highlighting that not existing neither economic nor financial capability by the States to increase themselves the expansion of their respective distribution pipelines networks - large consumers can make the necessary investments in order to meet your needs.
- How to think in free gas consumer in a nascent gas market with great concentration on Petrobras, and without a physical guarantee that this energy source will be available to meet the projected needs of domestic demand?
- Aggravating factors:
  - ✓ International economic crisis, emerged in American sub-prime house markets U.S.;
  - ✓ Necessity of both the state and federal government articulate themselves with the private sector, through the PPP instrument.

## CONCESSIONS FOR NATURAL GAS TRANSPORTATION CONTRACTED FROM 11.909/2009 LAW

- Time-period: 30 years
- Extension: maximum of 30 years, respecting the conditions established into the concession contract through a previous notice
- **Main Concessionaires Obligation:**
  - ✓ Celebrate with shippers transport contracts in all types of service offered, which must be previously approved by ANP;

# THIRD PARTIES ACCESS TO GAS PIPELINE NETWORK

- Contracting:

- ✓ First, occurs primarily on the available capacity not contracted.
- ✓ After its full contractation, it will be guaranteed the access right to spare capacity
- ✓ It authorized the transfer of capacity - in whole or in part, of the right to use the contracted transport capacity under the steady mode.

# REGULATION ON GAS POLITICS: SHORT RUN CHALLENGES

- Regulation of many articles. For example:
  - Tariff regulation in transport activity;
  - Open season process for new pipelines and its expansion
  - Pipelines for free consumer, auto-producer, and self-importer
  - Federal Contingency Plan
  - Providing the necessary tools for ANP in order to make it capable to link up with both state regulators and state environmental , in order to reconcile and unify the norms applicable for BNGI and gas markets used by federal regulators and state ones.
  - Establishment of rules, which it should be employed by MME in the definition if a gas transportation pipeline is of national interesting or of a specific interesting of a single company.
  - Rules for defining the exclusivity period to be adopted by MME
  - Form of contracting into both the interruptible and extraordinary modality of capacity
  - Definition that the distributor company recognize the impossibility of attending the needs of some actors of BNGI;
  - Rules that establish criterias and conditions, to flexibilize both supply and demand for gas.
  - State Rules in defining who are the free-consumers in each State of Brazil
  - Incentive in the long run In order to be created the free consumer legislation for in the states, as it would be increase the competition in production and it would be able to increase the amount of companies interesting to transport natural gas in Brazil
  - Setting criteria for reviewing the transportation tariffs within gas sector by ANP. Does it ensure the economic efficiency?
  - Definition of what it means is tge of the expression: “best practices into the BNGI”.
  - Estabilishment guidelines for the natural gas use as raw material in the industrial productive processes by CNPE
- Structuring the sectorial planning in a market context
  - Defining which it will be the type of planning (indicative or determinative?), including as to the specifics of the transportation pipeline
  - Defining a national policy for gas
  - Allocating of human resources
- Politics on gas
  - Role of integration
  - Role of LNG
  - Transparent pricing policy for each of the gas markets
  - Consumer segments priority for expansion, including in the context of contingency.

## REGULATION ON GAS POLITICS: LONG RUN CHALLENGES

- Strengthening the capacity of regulation and enforcement of ANP until the downstream segment.
- Protection of competition, ensuring that the bidding process in Brazilian gas sector in the upstream will result in increased competition in this segment,
- Advancement of state regulation
- Arbitration of disputes between BNG actors
- Definition of strategic guidelines

# KEY QUESTIONS FOR THE FUTURE OF BNGI (1)

- In the long run, the domestic gas would be plentiful in Brazil?
- Brazil will be exporting gas?
- How will evolve between the thermal and industrial markets?
- Brazil will have a government policy to gas domestic prices in each market and at the same time transparent as well?
- By increasing competitive pressures in the upstream, without a counterpart in the downstream, tends to produce points of "regulatory bottlenecks" in the gas distribution segment. How to ensure that this does not occur, if 11.909/2009 preserved both the BNGI structure and the market power of Petrobras?
- How to eliminate the asymmetry between the federal regulation of gas pipelines and the state one?
- How to live harmoniously with different rules of exclusivity period between the existing pipelines and the new ones?
- How to ensure that there will be a permanent improvement in the contracts, once that we can see the interfaces with other contracts, and its effects, which creates an intricate judicial relationships, if the gas law preserved a significant part of the previous contractual structure?
- Encourage in the long run the emerge of legislation creating the free consumer of gas in states, as it would be competition in production and the presence of new transport natural gas. And how to reconcile the different state rules, which defining the free consumer with the other links of the gas chain?

## KEY QUESTIONS FOR THE FUTURE OF BNGI (2)

- Free access to pipelines will be available to small investors? If so, when and in what form it will be guaranteed? This is of essential importance for the development of BNGI, as it would ensure the inclusion of new agents in the both gas production and commercialization activities, including encouraging competition in the upstream segment.
- What is the role of the Ministry of Mines and Energy and of the Energy Research Company (EPE) in the preparation of studies on the expansion of Brazil's pipeline network?
- In contingency situations with immediate effect, how would it be possible to ensure that there will be no asymmetry between the federal contingency plan, and state one?
- How CNPE will establish safeguards in the use of natural gas as raw material in industrial processes in a efficient and compatible way with both domestic and foreign markets?

# POLITICS FOR THE GAS SECTOR

- A scenario of greater abundance tends to create pressures for policies aimed at:
  - Priority for attending the gas domestic markets
  - Greater state intervention in the sector:
    - ◆ Transport sector (transportation and gathering pipelines)
    - ◆ Definition of clearer gas pricing policies
    - ◆ Redefining the role of thermal plants in this new scenario.
    - ◆ Redefinição do papel das térmicas neste novo cenário.

# CONCLUSIONS

- Although the perception the former regulatory framework was inadequate to promote the development of Brazilian GNI, very few changes have been introduced in the new gas law.
- There are 6 main players or group of players in the negotiation of the new gas law, but only three of these can be considered Veto Players. Those were the less committed with reforming the *status quo*.
- The players more committed to the reform did not have power to define the negotiation agenda and to act as Veto Players.
- ⇒ New gas law has been approved with very few gains for the large gas consumers and private gas upstream operators.
- ⇒ Level of competition in Brazilian NGI tends to remain very low in the years to come.
  
- Petrobras market power tends to be questioned by the other players, resulting in a significant level of conflicts.
- Asymmetry between federal and state gas regulation is a potential source of regulatory conflicts in the Brazilian NGI.
- Some driving forces for increasing the competition in the downstream segment: (i) increasing the competition in the upstream; and (ii) the need to flexibility in natural gas demand, in order to accommodate the fluctuation of thermal power plants gas demand.

**THANK YOU!**

**VIELEN DANK!**

**MERCI BEAUCOUP!**

**MUCHAS GRACIAS!**

**MUITO OBRIGADO!**