

MARTIN & DROUGHT, P.C.

LEGAL UPDATE

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Mexican Oil And Gas Reforms

After twelve months of intense debate and speculation, Enrique Peña Nieto, Mexico's President signed a bill into law which creates a market-oriented energy sector for that country. The first and most difficult step was achieved on December 20th, 2013 with the publication of a decree with constitutional reforms and additions in energy matters ("the Reforms"), putting an end to very sensitive national and partisan discussions of controversial social and political issues that had derailed several bills over the past seventy years.

So far, the Reforms are circumscribed to three (03) articles of Mexico's Constitution (Arts. 25 [***National Development***], 27 [***National properties, assets, and rights over natural resources***] and 28 [***Monopolies and economic competition***]). These three (03) amendments and additions shed a clear light to the future of the industry in Mexico; however, the "transitory" articles of such decree reveal the real target and goals of the Reforms. Mexico's Congress has 120 days to discuss and pass "secondary" legislation that will give the final shape and structure to Mexico's new and revamped energy sector.

The Reforms encompass both hydrocarbons and electricity markets. This legal update covers only the hydrocarbons market. An update on electricity markets will follow.

The Reforms have input and collect on the expertise of local and foreign petroleum companies, and while mineral rights will continue to be owned by the Mexican state, the new legal regime allows contractors to be paid "in-kind" and to book reserves. The magnitude of this *tour-de-force* gives Mexico a competitive legal framework away from the market inefficiencies created by the previous state monopoly managed under PEMEX.

Mineral rights under the Reforms:

- The Mexican state will hold title to the hydrocarbons beneath the surface in "fee simple and absolute".
- No government concessions will be granted.
- Contractors will only take title to the hydrocarbons output which is at the "well's head" and never of the petroleum within the reservoir.
- A dominant estate is being created; O&G activities prevail over mining activities.

Contractual regimes and payment under the Reforms:

- PEMEX will be transformed from its current legal status into several “*State Productive Companies*” [*Empresas Productivas del Estado*]. With this, more administrative independence is expected; likewise, the transformation of PEMEX will help avoid any confusion with regards to the “sovereign immunity” doctrine.
- Contractors will be entitled to book reserves as long as it is expressly recognized that hydrocarbons continue to be owned by the Mexican state.
- Contractual regimes allowed by the Reforms include:
 - o Services Agreements.
 - o Profit-Sharing Agreements.
 - o Production Sharing Agreements.
 - o Licenses.
- Methods of payment to contractors allowed by the Reforms include:
 - o In cash, for Services Agreements.
 - o Share of profits, for Profit Sharing Agreements.
 - o Share of production, for Production Sharing Agreements.
 - o Other valuable consideration for produced hydrocarbons, for Licenses.

The Reforms also cover many different aspects of public administration policies such as the creation of a Mexican Petroleum Fund, rules for operating, and a process of assignment of fields and sectors in a so called “round zero” where *State Productive Companies* will be the sole assignees.

The Reforms are general in nature, and as expected, many of the remaining questions will be answered with the enactment of secondary legislation within the next four months. For instance government take, terms and conditions for opening a midstream sector, areas and fields that will be offered for tender, national content, as well as model contracts to name a few.

The new constitutional framework provides a solid foundation for a market oriented industry allowing more players to participate in upstream and midstream activities on their own, and in a less government controlled environment.

US and other foreign companies in the O&G industry have been waiting years for the Reforms, and despite all the lingering questions yet to be answered, it is clear that Mexico’s O&G industry is finally heading in the right direction.

Texas’ proximity to Mexico but more important, a well established and thriving O&G industry throughout the State of Texas, will allow experienced companies a preferred opportunity to participate in such a historic event for Mexico.

This article is designed to provide information regarding the subject matter covered and is not to be considered as legal advice by the authors.

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