

Oil and Gas 2018

Mexico

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Nader, Hayaux y Goebel SC

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Reference

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1 What is the legislation applicable to oil and gas activities in your country? Is it federal or state legislation, or both?

The Mexican Constitution provides the general framework of the oil and gas industry. A compilation of laws, regulations and administrative rulings implement the constitutional provisions. Some of the secondary regulations include the Hydrocarbons law, the Hydrocarbons Revenue law and the Petróleos Mexicanos (Pemex) law. The legislation on hydrocarbons is federal.

2 Are oil and gas activities carried out by the state or a state-owned agency or national oil company?

Before the Energy Reform, oil and gas activities were exclusively carried out by Pemex (the Mexican national oil company), and the private sector only participated via services contracts with Pemex. After the Energy Reform of December 2013, private companies are now entitled to participate in oil and gas activities where Pemex continues to be a participant thereof. The legal framework allows Pemex to carry out oil and gas activities by itself or in joint ventures with other participants.

3 Is oil and gas a regulated business that can only be carried out by companies that are licensed or that receive government concessions to operate?

Yes, Pemex and the private oil and gas companies may only carry out activities through different regulated schemes. In the upstream sector, Pemex receives entitlements directly by the Ministry of Energy to carry out its activities. Private parties, or Pemex in joint venture with private parties, are awarded exploration and production contracts by the National Hydrocarbons Commission.

Relevant exploration and production contracts can only be obtained via a public bidding process. Midstream and downstream activities, in general, require permits issued by the Energy Regulatory Commission. The oil and gas activities in Mexico are heavily regulated by the Ministry of Energy, the Energy Regulatory Commission, the National Hydrocarbons Commission and the National Industrial Safety and Environmental Agency.

4 Identify the regulatory agencies charged with regulating oil and gas activities in your country and describe the role each agency plays in regulating such activities.

The Ministry of Energy determines the five-year public bidding plan for upstream activities. Moreover, such Ministry decides on the acreage and selection of fields to be awarded. In addition, it grants entitlements to Pemex and defines guidelines for the tenders to be carried out by the National Hydrocarbons Commission and grants permits for treatment, refining and processing of hydrocarbons.

The Ministry of Treasury and Public Credit establishes the regime for the revenue to be obtained from upstream hydrocarbons activities (tax, royalties, contributions, tariffs, among others), by providing the fiscal terms of the contracts and the amounts to be delivered to the Mexican Petroleum Fund and being in charge of providing their supervision.

The Ministry of Economy is responsible for the determination and supervision of the methodology to measure the national content for the blocks and contracts awarded.

The National Hydrocarbons Commission manages, oversees and regulates upstream activities. The Commission grants, subject to the fulfilment of the required procedures, licences, exploration and production contracts and geophysical and geological exploration permits. In addition, such Commission manages the National Hydrocarbons Information Centre, carries out the tenders to award upstream contracts, manages and supervises the activities to be carried out within the boundaries of contracted fields. Likewise, the Commission certifies and quantifies the oil reserves.

The Energy Regulatory Commission is in charge of regulating the midstream and downstream activities. Such Commission grants permits related to transportation, distribution, storage and commercialisation activities that are non-related to contracted fields.

The National Industrial Safety and Environmental Agency establishes the national standards for the upstream, midstream and downstream activities and supervises the facilities and activities of the hydrocarbons sector regarding compliance with the industrial and operative safety and environmental protection regulations.

The Mexican Petroleum Fund is a public trust that receives, manages, and distributes the applicable revenue deriving from the upstream contracts awarded. The Mexican Central Bank acts as trustee of the Mexican Petroleum Fund.

The Federal Antitrust Commission is engaged in ensuring that the activities and operations in the upstream activities be carried out in a competitive environment for the efficient development of the markets.

5 Are all hydrocarbons in your country deemed to be originally owned by the state? If so, when does ownership transfer to the extractor or buyer of the hydrocarbons?

Yes, hydrocarbons are originally owned by the state. The original ownership of the hydrocarbons is transferred at the wellhead.

6 How are oil and gas exploration and production rights or concessions granted? Is there more than one method for granting such rights (ie, concession and joint exploration agreements) or co-existing regimes applicable to different exploration or production areas?

There are mainly two regimes to grant exploration and production rights in Mexico. Firstly, Pemex may be granted with an exclusive entitlement to explore and produce oil and gas in a certain area. Secondly, in all other cases oil and gas exploration and production rights are granted through a bidding process carried out by the National Hydrocarbons Commission. Each bidding process establishes the type of contract that will be used for the granting of such rights, which can be a licence, a profit sharing contract or a production-sharing contract. Likewise, Mexican law allows Pemex to carry out farm-outs on certain blocks originally awarded to Pemex for such entity to enter into a joint venture agreement with other participants. The joint venture agreement is also subject to a competitive bidding process.

Oil and gas exploration rights might be obtained by any interested party through a geophysical and geological exploration permit issued by the National Hydrocarbons Commission. Such rights do not grant the right to drill or become the exploration and production contractor or the licensee of any blocks containing oilfields discovered by the title holder of the relevant geophysical and geological exploration permit.

7 Is there a public bidding or similar process for oil and gas exploration and production licences? If so, is it open to foreign companies and investors?

The public bidding process applicable for oil and gas exploration and production licences is the same as the mentioned before in question 6. Such bidding process is open to Mexican companies, which may have foreign shareholders and/or investors.

8 Are there any minimum local content requirements related to international bidding processes?

The Hydrocarbons Law establishes that the activities of exploration and production of hydrocarbons carried-out through awarded contracts shall comprise, on average, 35 per cent of national content by 2025. The contractors shall comply, individually and progressively, with a minimum content that the Ministry of Economy shall determine for the contracts awarded.

For that purpose, the Ministry of Economy has issued a mechanism to measure the national content that the awarded parties have to comply with in regard to each relevant contract. Goods, manpower, services, training, technology transfer and infrastructure are areas taken into consideration to calculate the applicable local content.

9 Are there any minimum capital or technical requirements related to international bidding processes?

Yes, all bidding processes have special capital and technical requirements which participants have to comply with in a prequalifying phase prior to the actual bidding process.

10 Are there any restrictions on foreign participation in such rights or concessions or in companies holding any such rights?

There is no foreign investment restriction on exploration and production activities. The contractors of exploration and production contracts or the licensees must be Mexican companies that are resident in Mexico for tax purposes, but there is no foreign investment restriction on such companies.

11 Are there any restrictions on the participation in such rights or concessions by state-owned entities or local national oil companies?

There is no restriction for Pemex or any of its subsidiaries (or for any other state productive companies), as well as for any state-owned entities on the participation in such rights or concessions.

12 Are companies or consortia that are awarded exploration and production rights given priority to operate and exploit the corresponding oil and gas fields? If so, how is such priority structured and documented?

If a party is awarded with an oil and gas exploration and production contract, it has the exclusive right to operate and produce the corresponding oil and gas fields. Said right is documented and structured in the exploration and production contracts awarded through a tender process. This implies that said parties have to abide to the contractual terms under the supervision of the National Hydrocarbons Commission.

13 What rights does the holder of an exploration and production licence or concession have to the hydrocarbons discovered during exploration and subsequently produced?

Generally, if there is an oil and gas reservoir discovery and the CNH authorises the development plan, the awarded party is entitled to produce in the discovered area.

14 May a holder of an exploration and production licence or concession transfer such right?

Any transfer of rights under an exploration and production contract has to be previously approved in writing by the National Hydrocarbons Commission.

15 Who has title to assets imported to develop and produce hydrocarbons, including any technology or expertise provided by foreign participants in the local oil and gas sector?

Any foreign participants owning assets, technology or expertise may retain title following the importation into Mexico.

16 How are federal, state and local governments recompensed for granting companies rights or concessions to conduct oil and gas exploration and production?

The Hydrocarbons Revenue Law provides the general structure under which the Mexican state obtains revenue from the oil and gas exploration and production activities (ie, through the execution of contracts, although the federal government also receives revenue through the Mexican corporate income tax applicable to the sector participants). Revenue from contracts awarded is delivered to the Mexican Petroleum Fund for its administration and distribution. Income tax is received by the Tax Administration Service of the Ministry of Treasury and Public Credit for its administration and distribution in accordance with the budget approved by the Mexican Congress. The Mexican Petroleum Fund must distribute a percentage of its earnings in accordance with a determined waterfall that includes distributions to the Budget Stabilisation Fund (for the benefit and use of the federal government) and to the State Budget Stabilisation Fund (for further distribution to the state governments) of the federal government. The Mexican Petroleum Fund Law also provides for distributions for the border and coast municipalities in which hydrocarbons activities take place. The states that are not hydrocarbons productive can be compensated under the terms and conditions set forth in the law, which is amended on an annual basis.

17 May companies or consortia that hold oil and gas exploration and production rights compulsorily acquire property or rights of way to carry out exploration or production activities? Are these compulsory acquisitions governed by special judicial or administrative proceedings?

Companies that hold oil and gas exploration and production rights may acquire property or rights of way to carry out relevant exploration and production activities. The Hydrocarbons Law provides a process in which the owners of the land or holders on possession of the land shall enter into negotiations with the awarded party. In addition, such regulation provides for a transparent process in which, among other matters, compensation, valuation of the land, remedies, agrarian law rights and enforcement of the terms and conditions agreed, are determined. Furthermore, the Ministry of Energy has enacted a model of agreement containing the minimum provisions that the parties must include in the agreement they enter into.

If no agreement is reached for the acquisition of the relevant properties or right of way, a judge could impose a legal easement.

18 Are natural gas exploration and production activities regulated separately or subject to the same regulation applicable to oil exploration and production? Are there different royalties or other government charges payable

by companies that conduct natural gas exploration and production activities?

Natural gas exploration and production activities are regulated under the same regulation applicable to oil exploration and production, the Hydrocarbons Law. However, the Hydrocarbons Revenues Law provides a particular structure for the determination of royalties for gas exploration and production activities that are charged to companies under the contracts awarded (different than the one applicable to oil production).

Some activities may require a special permit in which case, fees for administrative procedures – related to the governmental attention of the permit request – are due.

19 Do foreign ownership restrictions apply to the oil and gas sector in your country?

As a result of the 2013 Energy Reform, the Foreign Investment Law was amended and no foreign ownership restrictions apply to the oil and gas sector. Nonetheless, the Foreign Investment Law provides Mexican companies carrying out navigation activities (cabotage) have a 49 per cent foreign investment limit. It is relevant to mention that under the Hydrocarbons Law any contractor or permit holder has to be a Mexican entity, but such Mexican entity has no foreign ownership restrictions.

20 Are there any minimum domestic participation rules or any labour law rules relating to domestic and foreign workers?

Mexican entities have an obligation under the Federal Labour Law to hire 90 per cent of Mexican workers, not including under such percentage the directors, administrators or general managers of such entities. Permits for foreign workers are granted by the National Immigration Institute.

In addition, awarded parties must comply with the minimum domestic content described under question 8. As mentioned therein, workforce is taken into consideration for calculating the minimum domestic content applicable for the relevant contract.

21 Are there any limitations on vertical integration in the oil and gas industry in your country?

General Mexican antitrust regulation would apply to the sector (eg, the Hydrocarbons Law provides for the Federal Antitrust Commission to oversee the prequalification and award mechanism for the granting of contracts on exploration and production activities).

In the upstream industry to date there have been no industry-specific limitations on vertical integration. However, the Hydrocarbons Law provides that the Regulatory Energy Commission shall issue rules on cross-participation for mid-stream activities. Those rules set out limits to the permit holders of transportation, commercialisation and storage of natural gas and refined products to avoid monopolies or affect the market, thus providing for a competitive market structure. In case cross-participation already exists with respect to players already holding two or more of such permits, the Federal Antitrust Commission and the Regulatory Energy Commission have to grant a favourable resolution for such players to continue participating in two or more links of the value chain.

22 Are oil and gas activities carried out through incorporated entities with limited liability or by consortia or other types of unincorporated joint ventures? Are joint venture partners jointly and severally liable for the obligations undertaken in connection with such activities?

The oil and gas activities can be carried out through a single Mexican company, with limited liability or not, or consortia (including through joint ventures). The members of a consortium are jointly and severally liable for the obligations undertaken in connection with such activities under the relevant exploration and production contract.

23 May oil and gas reserves be pledged or encumbered to secure the repayment of debt? How?

Oil and gas reserves belong to the Mexican nation, thus, they cannot be pledged or encumbered to secure the repayment of debt before their extraction. However, in the case of licence contracts and production sharing contracts, once the oil is extracted and processed in accordance with the respective contract, title is transferred to the contractor and the hydrocarbons may be sold, pledged or encumbered.

24 Can oil and gas rights that are subject to a lien be sold or transferred freely by the secured creditor? What issues, if any, do secured creditors face in enforcing liens on oil and gas rights?

In accordance with recent exploration and production contracts, no liens can be imposed on the rights of the contractor under such agreement or on the facilities or assets of the contractor used to comply with such agreement without the previous authorisation of the National Hydrocarbons Commission.

Accordingly, oil and gas rights under an exploration and production contracts can only be transferred if previously approved by the National Hydrocarbons Commission, including any secured creditor. The challenge of any secured creditor will be to structure the collateral package and close the transaction by previously negotiating and obtaining the relevant written authorisation from the National Hydrocarbons Commission.

25 Is oil and gas output freely exportable in your country? Are there any limits or quotas applicable to oil and gas production? Is there access to export pipelines? What licences are required for oil and gas exports? Are duties or tariffs applicable?

A permit granted by the Ministry of Energy is required to export oil and gas. There are no limits or quotas applicable to oil and gas production. Exporting pipelines, in general, have the same legal framework as intranational pipelines, including open and not unduly discriminatory access. A permit from the Ministry of Energy is required to import oil and gas into Mexico. Finally, oil and gas exports are not subject to export taxes, but customs fees (which are determined on the basis of fixed fees) will apply.

26 Are prices for oil and gas set or fixed by the government?

Prices for oil and gas are determined by the international market, with no governmental interference.

27 Are oil and gas exports taxed under the general income tax regime or is there specific hydrocarbons tax legislation?

The participants in the Mexican oil and gas market must be Mexican resident companies for tax purposes, subject to the provisions of the general income tax regime provided in the Income Tax Law and to certain additional provisions contained in the Hydrocarbons Revenue Law.

28 Do special environmental rules apply to oil and gas exploration and production?

General existing environmental regulation will be applicable to oil and gas exploration and production. Nevertheless, the National Industrial Safety and Environmental Agency has issued certain regulations in connection with the operative safety and environmental protection of the oil and gas industry.

29 Are environmental regulations in your country consistent with any international standards?

Yes, under the Measurement and Standardisation Law the national standards have to comply with international standards and regulations to a certain extent. American Petroleum Institute (API) standards are widely used in Mexico.

30 Do special health and safety rules apply to oil and gas exploration and production?

Yes, the provisions enacted by the National Industrial Safety and Environmental Agency contain rules applicable to health and safety aspects.

31 Must companies that participate in the oil and gas industry obtain special environmental or other government permits (other than licences or concessions to carry out oil and gas exploration and production) to operate in your country?

Yes, the National Industrial Safety and Environmental Agency has to approve the environmental impact and risk assessments of the hydrocarbons sector and will issue a “base line” of the environmental conditions of the contractual area before and after the relevant activities with respect to (i) protection, conservation, and restoration of ecosystems and natural resources; (ii) waste characterisation and management; (iii) pollutant emissions control; (iv) technical elements for the country’s environmental and energy policies; and (v) authorisations of forest land use permit modification, if applicable, among others. A social impact affidavit shall be filed to obtain contracts and permits in the hydrocarbons industry.

If the contractor is interested in participating in other activities regarding the oil and gas value chain, each activity requires a specific environmental permit.

32 Does the government (including any development banks or agency) provide financing, subsidy or other support to companies undertaking oil and gas exploration or production?

The Hydrocarbons Revenue Law provides that the federal government shall provide financing methods through the development banks to allow individuals or entities to invest in any section of oil and gas value chain.

33 Are there any tax stability or similar regimes available to foreign investors undertaking investment in the oil and gas industry in your country?

Mexican laws do not provide tax stability or similar regimes for foreign investors. However, Mexico has signed several International Agreements for the Protection of Foreign Investment with a variety of other jurisdictions that – even without providing a tax stability regime as such – aim to prevent a possible interference and even expropriation of the foreigner's investments.

34 Are oil and gas activities generally protected under bilateral investment treaties entered into by your country?

As a result of the Mexican Energy Reform, investments in the oil and gas industries should now be protected, unless expressly excluded in such treaties by the Mexican state. Nonetheless, the Mexican state is including provisions regarding the investment in the oil and gas sector in treaties currently being negotiated (ie, North America Free Trade Agreement).

35 Are there any dispute resolution systems specific to the oil and gas industry? Does state immunity apply in such disputes?

The Hydrocarbons Law expressly provided two dispute resolution systems for exploration and production contracts. In general, any dispute regarding the exploration and production contract can be resolved pursuant with alternative conflict resolution methods (including arbitration). Nevertheless, any dispute that derives from the relevant contract's administrative rescission must be solved by Mexican courts.

36 Do anti-corruption rules apply to the oil and gas industry?

Yes, the Hydrocarbons Law expressly includes transparency and anticorruption mechanisms. Such Law provides the type of information that must be considered as public and that the contract bidding procedures, execution and compliance of awarded contracts, permits and authorisations have to comply with the anticorruption regulation. In addition, the Hydrocarbons Revenues Law provides transparency and scrutiny provisions that must be complied with by the Mexican Petroleum Fund and the Ministry of Treasury and Public Credit.

37 Has your jurisdiction adopted any legislation or regulations governing the exploitation of shale gas (fracking)? Are any special licences or environmental permits required for such activities?

The National Industrial Safety and Environmental Agency has issued regulations regarding fracking production methods.

38 Has your jurisdiction adopted any legislation or regulations governing ultra-deep-water exploration or drilling activities? Are any special licences or environmental permits required for such activities?

In December 2016, the National Industrial Safety and Environmental Agency issued specific rules for deep water activities.

39 Have there been any recent material amendments to the laws, rules or regulations governing hydrocarbon exploration and exploitation? Have any new laws, rules or regulations governing hydrocarbons exploration and exploitation been passed in your jurisdiction?

The Constitutional and legal frameworks are very recent and have not been modified since their enactment. Secondary regulations are issued very frequently as the new regulatory framework derived from the energy reform continues to be implemented.



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Mr Arangua specialises in capital markets, structured finance, M&A and energy. He is recognised as a leading lawyer by *Chambers Latin America*, *IFLR1000*, *The Legal 500* and *LL250*, for his outstanding expertise. *Chambers Latin America* ranks him as a leading individual for capital markets, describing him as “one of the hardest-working lawyers in the market, who always goes the extra mile to ensure that everything is perfect”, and that “he is incredibly technical and methodical, as well as having great business sense and a hands-on attitude”.

He is an expert in securities and regularly advises both private and public companies on issuances in the local market and abroad. He has also developed niche expertise in CKDs (development capital certificates).

His structured finance practice is focused on providing advice to lenders on structuring complex bankruptcy-remote payment structures.

He has developed expertise in the oil and gas sector, in which he has continuously advised on capital markets, finance and M&A matters.

Mr Arangua has strong international experience. He is licensed to practise in New York and regularly advises US and other international clients on transactions in Mexico.

He obtained his LLM from the University of Michigan Law School, having graduated as a lawyer from the Instituto Tecnológico Autónomo de México (ITAM).



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Mr Valadez specialises in taxation matters, and he concentrates his practice on federal income tax and international tax, including cross-border M&A and joint ventures, in-bound investments into Mexico, as well as structuring and implementation of collective investment vehicles (such as private equity funds) managed by Mexican and foreign sponsors.

He has a solid experience in advising his clients on issuances in the local securities market, particularly in the case of development capital certificates (commonly known as CKDs) and exchange-traded funds (commonly known as ETFs).

As part of this practice he regularly advises multinational clients making investments in Mexico, or which have commercial relationships with companies in Mexico. He also spent six months working as a foreign associate in the Amsterdam, Luxembourg and Geneva offices of Loyens & Loeff.

He graduated with honours as an attorney from the Instituto Tecnológico Autónomo de México (ITAM).

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Oscar's practice focuses on the energy, mergers & acquisitions, banking and finance and corporate areas, including joint ventures and foreign investment.

Oscar has an extensive and wide experience in the sectors he has advised, including renewable and non-renewable sources of energy, pharmaceutical, insurance, technology, telecommunications, among others.

Oscar regularly assesses national and multinational companies, national and international financial institutions, private equity funds and public listed corporations, as well as governmental entities.

Oscar graduated from Escuela Libre de Derecho, attorney at law (2013), holds a postgraduate degree in energy law also from Escuela Libre de Derecho (2015) and received his LLM with merit in energy and natural resources law from Queen Mary University of London (2017) sponsored with a Chevening Scholarship awarded by the British Embassy in Mexico on behalf of the United Kingdom of Great Britain and Northern Ireland.

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