THE STEPS TOWARD BETTER CONTRACTING

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Q: How would you rank the attractiveness of Mexico as an oil and gas investment destination?

A: It is difficult to compare the current state of the Mexican oil and gas industry, which has very recently opened up to private investment, and is still in the process of implementing all of the secondary and tertiary regulations of the Energy Reform, with other industries that have allowed private participation for decades. Nevertheless, Mexico's legal regime applicable to oil and gas activities has been modified after studying and identifying the successes and failures of several types of regimes on a global level, the best international practices, and the particular circumstances and potential of our country. Therefore, in general terms, the regime is designed to be competitive and attract foreign investment.

Q: What are the main highlights regarding new opportunities in the Mexican market?

A: An example of some of the newest local opportunities would include the fact that, as laid out in President Peña Nieto's announcement in February, as of April 1, 2016, any company that meets the applicable legal requirements may import gasoline and diesel, an activity previously reserved to PEMEX. Due to the price spread between the national price of gasoline and diesel and that of other countries, there could be an interesting business opportunity here if the traded volumes are high enough. Another thing to take into account is that practically all of the refined products storage and pipeline transportation infrastructure in Mexico is owned by PEMEX, due to the fact that prior to the Energy Reform, PEMEX was the only user of these facilities. Much of this infrastructure dates a few decades back and has not received proper maintenance over the years. Furthermore, some of the pipelines have a significant illegal tapping problem. All of these circumstances present a scenario of interesting opportunities in which to improve and provide maintenance to existing infrastructure in Mexico.

Q: How successful has the government been in structuring and administering E&P contracts so far, and what learning curve have you identified from R1-L01 to R1-L03?

A: CNH has restructured and adapted the model contract several times to address the concerns of the industry regarding several issues, such as the possibility of superficial recognition and exploration data trading and transfer. These changes have resulted in a more polished contract model that has served and will serve as the basis for future tenders. Likewise, it has refined the bid presentation event to include faster bid valuation methods that take into account electronic means, without sacrificing the transparency in the process. As for the administration of the contracts, it is in its infancy since most, if not all, of the R1-L03 contracts have yet to be executed, and the R1-L01 contracts will remain in exploration phase for at least a few more years.

Q: What are the main advantages of Mexico's upstream contracts for the private sector?

A: The advantages depend on the type of contract. Production sharing contracts and license contracts give title and possession of the hydrocarbon production, as opposed to profit sharing and services contracts that only grant economic interest in the production. In this sense, it is important to note that so far, only production sharing and license contracts have been tendered and awarded. One concern regarding license contracts is that the main bidding variable is a percentage of additional royalty over gross revenues instead of a percentage of the operating profit. This is a variable that does not share the risk of higher costs between the government and the contractor, and therefore, it might not be considered attractive for some investors. I would recommend that the government carefully select the type of contract for each block, a responsibility of the Ministry of Energy, instead of changing the nature of contracts, which would require the legislators to modify the law.

Rodríguez Dávalos Abogados *is a legal consultancy firm that provides both legal and business advisory to national and international clients in the Mexican oil and gas industry; another Q&A in the next chapter is dedicated to Jesús Rodríguez Dávalos perspective on Round One.*