

## Mexico's Oil Reform Plans Will Attract Intrepid Investors

By **Keith Goldberg**

*Law360, New York (June 19, 2013, 8:02 PM ET)* -- Mexico's president has announced plans to break the country's 75-year monopoly over oil exploration and production, a move experts say could make Mexico a major player in the global oil-and-gas market and have industry giants lining up for a piece of the action — as long as there's some assurance that reforms will have staying power.

President Enrique Pena Nieto, who made reforming the country's nationalized hydrocarbon industry an issue when he was elected last year, said this week that he was encouraging lawmakers to allow the private sector to invest in oil exploration and production. Since nationalization in 1938, exploration and production has been the exclusive domain of state-owned Petroleos Mexicanos, commonly known as Pemex.

Mexico is already one of the world's largest oil producers, pumping out 2.5 billion barrels of crude oil per day in 2011, but production has steadily fallen since 2004, according to the U.S. Energy Information Administration, which expects it to continue to decline if there are no major changes in technology or policy.

There's little doubt that Pemex desperately needs an injection of capital and technical knowledge in order to boost flagging oil and gas production, especially in the country's deepwater and shale gas plays. While details of proposed reforms haven't been made public yet, experts say opening up Mexico's oil sector to private competition could spark a flood of investment from energy majors eager to tap the country's estimated 10 billion barrels of proven oil reserves, as well as one of the world's largest shale gas resource bases.

"If they pass comprehensive reform that will allow private players to participate in exploration and to book reserves, it will generate so much investment and make the country a major player in the global oil and gas arena," Morgan Lewis & Bockius LLP business and finance partner Rodrigo Dominguez Sotomayor told Law360. "You don't need to be an oil and gas genius to know that the current system is not working and is plagued with inefficiencies that they need to get rid of."

Mexico has taken smaller steps to liberalize its oil and gas industry — the government opened up midstream and downstream gas operations to private investment a couple of decades ago and, in 2008, allowed private investment in midstream and downstream oil activities and gave Pemex more flexibility to contract out services that would improve exploration and production.

Still, ownership of the oil and gas remains with Pemex. Loosening the state's grip on exploration and production would represent a major sea change in Mexico's energy industry, but there are plenty of political and legal obstacles, experts say.

Pemex isn't just one of Mexico's biggest moneymakers, it's a source of national pride. The 1938 nationalization was carried out under the auspices of the Mexican constitution, which states that the country's natural resources belong to the nation.

"It was one of the changes that followed the Mexican Revolution — it's at the core of Mexican culture," Akin Gump Strauss Hauer & Feld LLP global project finance partner Dino Barajas told Law360. "If you change something that's been part of the Mexican psyche overnight, there's likely to be a public backlash."

Privatization of Pemex is a nonstarter, experts say. Reforms are likely to be more modest, such as allowing joint exploration and production ventures between the private sector and Pemex, or the government leasing production blocks and collecting royalties.

"In the short term, it would have to be a gradual opening of the market, allowing private companies to jointly participate along with Pemex, rather than an outright sale of blocks," Barajas said. "I don't think political opinion would support that."

Still, the question of whether such reforms could pass constitutional muster is a major concern, according to McDermott Will & Emery LLP project finance partner Alex Choinski.

"It would be nice to have a constitutional amendment, but the chances of that happening are politically challenging," Choinski told Law360. "The bottom line is you want to create some sort of legal and political stability for investors, especially for capital-intensive deepwater and shale plays, such that their concession rights aren't going to be challenged constitutionally."

A demonstration that there's broad-based political support for any reforms is crucial as well, as investors will be leery about sinking billions of dollars into new oil-and-gas infrastructure if a new administration decides to take it away, according to Barajas.

Still, Mexico's relative political and economic stability compared to many other oil-producing nations, its close proximity to the U.S. and its bevy of international trade and development agreements make it an appealing prospect for the industry, which has waited to get back into the country for at least 20 years, experts say.

"The investment dollars are there, so this [proposed reform] would simply be the next permutation that's been a long time coming," Barajas said. "But I think [oil and gas firms] are going to be cautious to ensure there's a broad-based, widely supported project [to invest in]."

That caution could limit the potential playing field to the oil and gas majors, experts say.

"Quite frankly, I don't think there are many companies around the world that have the capabilities and risk appetites aside from the big U.S. companies and maybe some European companies," Dominguez Sotomayor said.

--Editing by Elizabeth Bowen and Chris Yates.