

## Energy Industry Readies For Mexico Push After Reforms

By Jess Davis

*Law360, Dallas (April 25, 2014, 5:04 PM ET)* -- As the energy industry eagerly awaits the release of Mexico's secondary regulations for the privatization of its oil and gas resources, energy lawyers say they're optimistic that the rules will foster international investment and are helping clients prepare to stake out a piece of the action.

Mexico approved landmark reform ending government control of its oil and gas resources in December, and its Congress was due April 20 to release a set of nearly 30 new and amended laws and regulations to implement the changes and create the structure for foreign bidding on the resources. Congress missed that deadline because of ongoing political negotiations, but is expected to propose new rules in the next few weeks.

In the months since Mexico changed its energy structure, businesses at every level — including large multinational companies, midstream developers, private equity-backed energy firms, service and storage companies, and the infrastructure industry — have been exploring their options and thinking about what opportunities they'll have once bidding for the Mexican resources is open. But companies have generally been cautious so far, taking preliminary steps to prepare for energy production in Mexico rather than diving into the deep end, lawyers say.

"There's not a wholesale movement to start forming companies in Mexico," said Jose Valera, co-head of Mayer Brown LLP's oil and gas practice. "There is a lot of anticipation but nothing concrete, because the framework to carry out those activities isn't out yet."

In-depth study is taking place at the businesses that see good opportunities in Mexico down the line, as companies position themselves for smooth entry once development is underway. Many of the companies eyeing the reforms don't have a lot of international experience, so they're setting up meetings in Mexico and looking for introductions to current market participants and key people.

According to attorneys, companies are also getting familiar with the nuts and bolts of setting up a business in Mexico, such as corporate entity structures, tax laws, and labor and employment rules. They're also seeking legal opinions about liability rules, changes in the law, financing and the kind of operations they'll be able to do in the country.

Carlos Sole of Baker Botts LLP says he's seeing clients lay the groundwork so that when it comes time to tackle the actual oil and gas opportunities, they can focus on those plays and service support for development rather than having to worry about day-to-day business operations.

"Expectations have grown," Sole said. "Mexico is cognizant of the unique opportunity they have and the need for foreign capital and technology."

Unlike the frenzied rush that follows discovery of a bountiful shale play in the U.S., Mexico energy development is likely to be only a portion of the overall development portfolio for American companies in the short term. Attorneys say government oversight will act as a siphon, regulating the pace of development by making only a certain number of blocks available in each round of bidding.

Once the rules are proposed, lawyers expect the majority of them to stay intact through the congressional approval process, and if the rules are released in late April or May, the minor delay shouldn't impact bid rounds planned for 2015. Meanwhile, rumors, leaks and proposed drafts with wide variations in terms have flurried around the Mexico legal scene, making it impossible to predict exactly what the final package of rules will look like.

The government could make the cost of participating in the exploration and production sector very expensive by adopting onerous taxes, high royalties and high national content rate requirements, which would make the economics of investing in Mexico no longer appealing to foreign capital, Sole says. But knowing that Mexico wants to emulate the success Colombia had several years ago and avoid some of the hurdles Brazil has faced, Sole says he expects the regulations to be friendly to foreign investment.

"The potential for that exists, but Mexican government officials are very cognizant this is a unique opportunity to attract foreign capital," Sole said. "They know their audience, they know they want to maximize the resources brought to the Mexican people, balanced with the foreign investment they can attract. They realize if they do it correctly, they can have a macroeconomic stimulus equivalent to [the North American Free Trade Agreement]."

Requirements for a national content percentage and for royalties paid to the government after oil and gas is extracted are on the table, but it's unclear at what level they'll be set, according to Baker & McKenzie LLP's Benjamin Torres-Barron, who leads the firm's energy, mining and infrastructure group in Mexico.

"Legislators are still studying the models of certain countries as Norway and Brazil, where royalties over hydrocarbon resources have been implemented in the past," he said.

Lawyers expect to see some flexibility in the final package, with different percentages established depending on the type of contract, so that deepwater drilling might have a small national content requirement but onshore drilling could have a higher one, helping Mexican companies stay competitive. The proposed rules will likely flesh out the constitutional amendments' intent to bring in foreign investment and dramatically ramp up production of Mexico's resources, attorneys say.

"The goal is that the regulations that ultimately come forth with a level playing field so that Mexican companies will have plenty of opportunities, but will be competing on the global level," said Mayer Brown's Dallas Parker.

Miguel de Erice of DLA Piper's Mexico City office says Mexican companies have requested an increase in the percentage of resources that would be allocated to Mexico-owned businesses, and have pressured the government to include a second "round zero" of bidding similar to that offered to Petroleos Mexicanos, or Pemex, the state-owned oil and gas development company.

"I think the government will not accept these proposals," he said. "They don't want to send message that this is not really an open procedure for Mexican and foreign companies."

It's likely the proposal could include a requirement that a Mexican company be a party to any contract signed with the government for drilling, similar to a U.S. Department of the Interior requirement for an American subsidiary to lease government resources, Valera says. But because the first round of bidding isn't likely to happen until mid-2015, he says there's no mad rush for foreign companies to start forming Mexican subsidiaries.

"We are in a period of transition," Valera said. "This is the calm before the storm in a way, but it's going to be a good storm."

--Editing by Elizabeth Bowen and Katherine Rautenberg.