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# 5 Tips For Energy Cos. Looking To Tap Into Mexico

By **Keith Goldberg**

*Law360, New York (May 27, 2016, 7:02 PM ET)* -- The landmark legislative reforms that opened up Mexico's energy sector after 75 years of state control have largely been implemented, with the Mexican government holding auctions for onshore and offshore oil and gas exploration, as well as new electricity projects.

Energy companies and investors are flocking to the country, hoping to grab a piece of the emerging energy pie, but attorneys say they must be mindful that they're still venturing into uncharted territory. That means adjusting to increased government involvement in potential operations compared to other countries, as well as a more complicated and expensive process to secure land or rights-of-way for projects.

"In many regulatory reform processes, there will always be a learning curve," said Benjamin Torres-Barron, who leads Baker & McKenzie's energy, mining and infrastructure practice group in Mexico. "The learning curve doesn't just affect investors — it affects the regulators. There's a huge amount of legal content that has been released and designed."

Here, attorneys offer five pieces of advice for energy companies looking to do business in Mexico as reforms continue to be implemented.

**Be Prepared for a Heavy Government Hand**

Mexico's energy sector may no longer be fully nationalized, but foreign energy companies looking to do business in the country must be willing to accept a level of governmental involvement they might not be used to elsewhere, attorneys say.

Companies interested in tapping Mexico's massive oil and gas reserves won't simply be dealing with the newly created hydrocarbon regulator known as CNH. They also have to deal with Mexico's energy ministry, which drafts production-sharing contracts, as well as the finance ministry, which sets the fiscal terms of the contracts. Not to mention the presence of national oil company Petroleos Mexicanos SA, or Pemex, which retains a significant home-field advantage despite no longer having exclusive control over Mexico's oil and gas.

In the power sector, the government has created and is running wholesale electricity auctions, and generation developers will most likely have to ink long-term power purchase agreements with the state-owned utility known as CFE.

“At the end of the day, you're going to have some limitations that you don't have in other countries, and that will affect the financial strength of your project,” said Mayer Brown energy partner Francisco Mendez, the former in-house counsel for ExxonMobil Corp.'s Latin America operations.

**Figure Out How Mexican Laws Apply to Your Contracts**

Though the general framework of a drilling or oil field services contract or a long-term power purchase agreement may be universal, companies looking to do business in Mexico must ensure those contracts can be adequately enforced under Mexican law to avoid losing any contractual rights or getting stuck with any unwanted liability, attorneys say.

“When you get up to an oil and gas contract, they aren't two-page contracts,” Mendez said. “You have to see how it's going to be ruled on under Mexican law. What are going to be the requirements you're going to need to fulfill?”

Joint operating agreements are commonplace within the oil and gas sector. Figuring out how Mexican law governs those agreements should be a priority for oil and gas companies before they make a deal, according to Akin Gump Strauss Hauer & Feld LLP partner Steven Otillar.

“We're looking at the allocation of risk among the parties and the allocation of liabilities for the parties,” Otillar said. “There hasn't been a joint operation for oil and gas in Mexico in decades — how will Mexican law apportion liability for gross negligence, for example? Every company is dealing with those concerns.”

And those concerns become more complex if a company partners up with state-owned Pemex, Otillar noted.

“Will they be subject to the same obligations that a private company will be involved in?” he asked.

**Allow Some Time for the Laws to Catch Up**

Given that Mexico only enacted the legislative reforms that opened up its energy industry to private and foreign investment in 2013, the pace of implementing the regulatory and legal structures to support those reforms has been remarkable. But attorneys say there's still plenty of work to be done, from crafting new environmental regulations to agencies clarifying the reams of rules that are already in place.

“Given the timeframe and the specific mandate by the government to execute the reforms in such a short period of time, we have to recognize that there might be a few discrepancies in the laws or ambiguities,” Torres-Barron said. “In the end, they have to be resolved by the regulators.”

Though any legal or regulatory gaps may eventually close, companies must realize that their window of investment might be bigger than originally expected if they want to get the regulatory certainty they desire, attorneys say.

“You have to be a little bit patient and give a little more time for the authorities or regulators to set the direction,” Torres-Barron said.

**Make Land Use Issues a Priority**

For companies looking to build an energy infrastructure project in Mexico — natural gas pipeline, transmission line, etc. — securing the necessary land or rights-of-way may be what financially makes or breaks the project, attorneys say.

“Paying attention to land issues and indigenous issues is really going to be an important factor because it drives costs significantly,” Otillar said. “The costs can skyrocket. If you're wrong on those numbers and the inherent costs, you're going to find yourself in an unprofitable project.”

Developers must satisfy a host of environmental, archeological and cultural requirements and win over local and indigenous communities that have been granted significant autonomy over approving projects within their territories. Unlike in the U.S., there is little use of eminent domain in Mexico, attorneys say.

“When dealing with agrarian communities and ethnic groups that are on a large amount of land, they are regulated under different rules,” Torres-Barron said. “They can really stop a project, or at least slow it down dramatically. You have the challenge to get the members of the communities to vote on and assess the project.”

Land issues are so critical in Mexico that some midstream oil and gas companies are buying up land rights before proposing their projects, according to Otillar.

“You have to have a sense of where things are being built, in advance,” Otillar said.

**Choose Your Local Partners Wisely**

Finding qualified Mexico-based business partners isn't just an advantage for foreign energy companies entering the country — it's a necessity, attorneys say.

A key aspect of Mexico's energy reforms were so-called local content requirements, which mandated foreign oil and gas companies to use Mexican products, services and workers for a certain percentage of their operations.

“Local partners will be key to the success or failure of a project,” Torres-Barron said.

The reforms established that companies with exploration and production contracts use a minimum of 25 percent local content in 2015, a figure that will increase to 35 percent by 2025. However, that doesn't include deep-water and ultradeep-water E&P activity — Mexican authorities would determine those percentages on a case-by-case basis.

Companies must do their homework on what local content will satisfy the government's requirements, and that will depend on the type of investments they're making, according to Torres-Barron.

“It might be the use of raw materials that are Mexican; another might be to subcontract to a Mexican nationality company,” Torres-Barron said. “You have to watch out for the local content rules that will apply to your investment project.”

--Editing by Christine Chun and Philip Shea.