

## Analysis of Mexico's New Hydrocarbons Legal Regime

This legal update addresses the main features of the Hydrocarbons Law and the Hydrocarbons Revenues Law, which became effective on August 12, 2014.

The Hydrocarbons Law and the Hydrocarbons Revenues Law are part of a set of new laws to implement the constitutional energy reform that became effective on December 21, 2013.

### I. Overview

Together, the Hydrocarbons Law and the Hydrocarbons Revenues Law establish a new legal framework for all hydrocarbon-related activities in Mexico, including the following:

- Surface and geophysical surveying, and exploration for, and extraction of, hydrocarbons;
- The treatment, refining, transportation, storage, marketing and sale of petroleum and petroleum products;
- The processing, compression, liquefaction, decompression and regasification, as well as the transportation, storage, distribution, marketing and retail sales, of natural gas; and
- Pipeline transportation and storage of petrochemicals.

For exploration and production (E&P) activities, the Hydrocarbons Law establishes two different regimes to be regulated by the National Hydrocarbons Commission (CNH): entitlements (called “*asignaciones*” in Spanish) granted to State Productive Enterprises (wholly owned

state entities, including PEMEX) and E&P contracts entered into with private parties or State Productive Enterprises. For midstream and downstream activities, the law establishes a “permit” regime to be generally regulated by the Ministry of Energy (SENER) and the Energy Regulatory Commission, as further described in Section III below.

Within 180 calendar days of the enactment of the Hydrocarbons Law, the executive branch is to issue the regulations (*reglamento*) under the Hydrocarbons Law.

### II. Upstream Sector

#### A. PEMEX ROUND ZERO

The transitional articles of the constitutional reform establish the so-called “Round Zero” process, during which PEMEX had the right to request E&P rights over areas that it currently has under production or that it is actively exploring. Any E&P rights granted to PEMEX under the Round Zero process would be under the entitlement regime (defined in Section II(B) below). One of the main objectives of the reform is that, after this initial round, PEMEX is to compete on an equal footing with other operators in obtaining additional contract areas.

On March 21, 2014, PEMEX submitted its Round Zero request to the SENER, requesting to retain the following:

- 100 percent of PEMEX's producing areas;
- 83 percent of Mexico's proven and probable reserves (2P Reserves); and

- 31 percent of Mexico’s prospective resources.

On August 13, 2014, the SENER announced that PEMEX will be granted all of the requested producing and 2P reserves, and 21% of Mexico’s prospective resources (instead of the 31% requested).

## B. ENTITLEMENTS

An entitlement is the administrative act by which the executive branch grants PEMEX or another State Productive Enterprise the right to explore and produce hydrocarbons in a determined area, subject to certain work program obligations, and for a particular duration.

SENER will be the entity responsible for granting or modifying entitlements to PEMEX or any other State Productive Enterprise for the performance of E&P activities.

The Hydrocarbons Law provides that entitlements shall be granted on an “exceptional” basis, which would seem to permit the granting of area entitlements to PEMEX even after the Round Zero process.

The Hydrocarbons Law provides that PEMEX (and other State Productive Enterprises, as applicable) may only assign or transfer an entitlement to another State Productive Enterprise and with prior consent from SENER. To meet its obligations under the entitlements, PEMEX may only enter into service contracts with private parties, which may only provide for cash payments to contractors.

It is through the entitlement regime that PEMEX has historically received areas for E&P activities in Mexico. However, the entitlements to be granted to PEMEX pursuant to the new legal framework will have stricter terms than the entitlements granted to PEMEX in the past, including work programs and mandatory relinquishment and termination events.

## C. MIGRATION TO CONTRACTS

The Hydrocarbons Law provides that PEMEX may request the approval of SENER for the migration of entitlements into E&P contracts. In this migration process, the Ministry of Finance shall establish the fiscal terms and SENER will establish the technical terms relating to the migrated contracts.

With respect to entitlements migrated into contracts, PEMEX may enter into joint ventures with private parties. The Hydrocarbons Law also establishes that, when PEMEX decides to enter into associations with private parties with respect to a migrated E&P contract, a tender process will be conducted by the CNH to select PEMEX’s partner.

The Hydrocarbons Law further provides that SENER will seek PEMEX’s favorable opinion with regard to the experience and the technical, financial and operational qualifications that bidders would need to meet in order to participate in the bidding process.

In regard to E&P services contracts that have been granted by PEMEX before the enactment of the Hydrocarbons Law<sup>1</sup> (namely, Integral Exploration and Production Contracts and Financed Public Work Contracts) and that are currently in effect, the following shall apply:

- The underlying contract area is expected to be awarded to PEMEX as part of the PEMEX Round Zero process;
- These contracts will not be modified by the enactment of the Hydrocarbons Law;
- The parties to those contracts may request SENER to migrate the underlying entitlement into an E&P contract under the new hydrocarbons regime;
- The migration will be conducted pursuant to the technical terms established by SENER (with PEMEX’s opinion) and the economic terms established by the Secretary of Finance, provided that they do not affect the balance of expected revenues for the nation;

- If the contract parties do not agree with the new contract terms, the original service contract will remain valid and unmodified;
- If the contract parties agree with the new terms, SENER shall approve the migration, and the CNH will sign a new E&P contract with PEMEX and its partner(s), which shall replace the original contract with PEMEX. In this case it shall not be necessary that CNH conduct a tender process to select such partner(s); in such case, the original service contract shall be terminated without any liability to the parties; and
- The investments made pursuant to the original service contract may be recognized as capital expenditures under the new E&P contract.

#### **D. E&P CONTRACTS**

Except for the migrations described in Part C above, E&P contracts shall only be granted through a competitive bidding process, organized and regulated by SENER, Secretary of Finance, and the CNH.

Under the constitutional reform and the Hydrocarbons Law:

- SENER is charged with selecting areas for public bidding and establishing the technical and financial qualifications for bidders;
- The CNH is charged with conducting the bidding process, evaluating bids and awarding contracts; and
- The Ministry of Finance is charged with establishing the economic and fiscal terms of the E&P contracts.

Pursuant to the Hydrocarbons Revenues Law, the variables to be evaluated for the award of E&P contracts will be economic in nature, with the prevailing principle of maximizing the nation's revenues. The Ministry of Finance will establish the economic variables to be evaluated, which will be the percentage of the value of production or percentage of production to be

received by the nation, the investment amounts committed by the contractor, or a combination of both.

The new contract models for E&P activities are: (i) licenses, (ii) production-sharing contracts, (iii) profit-sharing contracts and (iv) service contracts. The Hydrocarbons Revenues Law provides for the economic aspects relating to each of the contract models.

##### ***i. License Contracts***

Pursuant to the Hydrocarbons Revenues Law, the license contracts shall provide for the following payments in favor of the nation:

- Signing bonus;
- Exploratory phase fees;
- Royalties; and
- A payment that consists of a percentage of the contract value of hydrocarbons produced.

The contractor may take and own the hydrocarbons in-kind at the wellhead. All of the above payments shall be paid in cash by the contractor. These payments are in addition to any taxes owed by the contractor pursuant to the Mexican Income Tax Law or other tax laws.

##### ***a. Signing Bonus***

The signing bonus amount shall be established by the Ministry of Finance in the bid terms for each tender process. The signing bonus is to be paid to the newly established Mexico Oil Fund.

The signing bonus will be paid at the moment and under the terms established in the specific tender process. The signing bonus amount will be fixed and will be determined in the bid terms. It will not be a factor in awarding the contract. The signing bonus is not expected to represent a significant percentage of the resources to be received by the nation but rather a mechanism to guarantee the seriousness of the economic bids.

### ***b. Exploratory Phase Fees***

License contracts shall establish a monthly payment during the exploratory phase with respect to non-producing areas. The concept is similar to the delay rentals usually established under oil and gas leases in the United States. The exploratory phase monthly fees are as follows: (i) \$1,150 Mexican pesos (having a current value in US dollars of approximately \$87) per square kilometer during the first 60 months of the contract term and (ii) \$2,750 Mexican pesos (having a current value in US dollars of approximately \$207) per square kilometer starting from month 61 of the contract term. These amounts shall be adjusted annually for inflation on the basis of the Mexican National Consumer Price Index. The purpose of these payments is to provide an incentive to the contractor to move promptly to the production phase.

The exploratory phase fees are to be paid to the newly established Mexico Oil Fund.

### ***c. Royalties***

License contracts shall establish royalties in favor of the nation that shall vary depending on the type and market price of the particular hydrocarbon (crude oil, associated and non-associated natural gas or condensates) effectively produced. Royalties are payable in cash.

Royalty payments shall be determined based on the “contract value” of produced hydrocarbons, which is calculated by multiplying the volume of production by its “contract price.” The contract price for each type of hydrocarbon is its market price in US dollars, as adjusted pursuant to a mechanism to be established in each E&P contract. The mechanism will take into account the hydrocarbon’s quality, API gravity, marketing, and transportation and logistical costs, among other factors.

Crude oil royalties start at 7.5 percent when the contract price of crude oil is below US\$48 per

barrel and would increase as the contract price of crude oil increases. When the contract price of crude oil is equal to or greater than US\$48 per barrel, the following formula would be applied:

$$\text{Rate} = [(0.125 \times \text{crude oil contract price}) + 1.5]\%$$

Per this formula, when the contract price of crude oil is US\$100, a 14 percent royalty would be applicable.

Condensates royalties start at 5 percent when the contract price of condensates is below US\$60 per barrel. When the condensates contract price is equal or greater than US\$60 per barrel, the following formula should be applied:

$$\text{Rate} = [(0.125 \times \text{condensates contract price}) - 2.5]\%$$

Per this formula, when the contract price of condensates is US\$100, a 10 percent royalty would be applicable.

As an economic incentive for non-associated natural gas development, a zero percent royalty would apply when the contract price of non-associated natural gas is lower than or equal to US\$5.00 per 1 million BTU. When the contract price of non-associated natural gas is higher than US\$5.00 but lower than US\$5.50 per 1 million BTU, royalties are calculated using the following formula:

$$\text{Rate} = \frac{[(\text{Natural gas contract price} - 5) \times 60.5]}{\text{Natural gas contract price}}$$

When the contract price of non-associated natural gas is equal to or higher than US\$5.50 per 1 million BTU, royalties are calculated using the following formula:

$$\text{Rate} = \frac{\text{Natural gas contract price}}{100}$$

The above economic incentives are not applicable to associated natural gas. Royalties for associated natural gas shall be calculated using the following formula:

$$\text{Rate} = \frac{\text{Associated natural gas contract price}}{100}$$

#### ***d. Payment that Consists of a Percentage of the Contract Value of Hydrocarbons***

The license contracts shall provide for a payment to be established on a contract-by-contract basis by the Ministry of Finance, depending on the type of project, consisting of a percentage of the contract value of hydrocarbons produced. This percentage, as offered in the bid process, would be a contract award criterion.

As mentioned above, the “contract value” of produced hydrocarbons is calculated by multiplying the volume of production measured by its “contract price.” The contract price for each type of hydrocarbon refers to its market price in US dollars, as adjusted pursuant to a mechanism to be established in each E&P contract. The mechanism will take into account the hydrocarbon’s quality, API gravity, marketing, and transportation and logistical costs, among other factors.

In addition, the contractor may be subject to minimum investments or work programs committed during the bidding process.

#### ***ii. Production-Sharing Contracts***

Pursuant to the Hydrocarbons Revenues Law, production-sharing contracts shall establish the following payments in favor of the nation: (i) exploratory phase fees (same as those applicable to licenses), (ii) royalties (same as those applicable to licenses) and (iii) a payment that consists of a percentage of operating profits. The exploratory phase fees are paid in cash, and the royalties and share of operating profits are paid in-kind. These payments are in addition to any taxes owed by the contractor pursuant to the Mexican Income Tax Law or other tax laws.

Depending on the fiscal terms established in each contract by the Ministry of Finance, the contractor receives in kind either (i) the cost recovery plus the balance of the operating

profits, or (ii) all production net of the production paid to the nation.

The operating profits shall generally be calculated by subtracting the following amounts from the contract value of the hydrocarbons produced: (i) the royalty amount paid by the contractor and (ii) the costs incurred by the contractor. Article 19 of the Hydrocarbons Revenues Law lists the costs that may not be deducted for purposes of calculating the operating profits.

Under the production-sharing contracts, the contractor retains in-kind production with a value equal to the recoverable costs and its share of operating profits. The production equivalent in value to the state’s share of profits is to be delivered to the marketing firm retained by the CNH.

These contracts will include an adjustment mechanism for the profit split rates so that the Mexican state “may capture the extraordinary profitability” from production.

#### ***iii. Profit-Sharing Contracts***

Pursuant to the Hydrocarbons Revenues Law, profit-sharing contracts shall establish the following payments in favor of the nation: (i) exploratory phase fees (same as those applicable to licenses), (ii) royalties (same as those applicable to licenses) and (iii) a payment that consists of a percentage of operating profits. These payments are in addition to any taxes owed by the contractor pursuant to the Mexican Income Tax Law or other tax laws.

As consideration, the contractor has the right to (i) recover costs as established by such law and (ii) receive a payment that will consist of the balance of the operating profits after paying the specified percentage of operating profits to the nation.

The contractor will deliver all of the production to the marketing firm retained by the CNH, which shall pay the sale proceeds to the Mexico Oil Fund. The Mexico Oil Fund shall retain the



amounts belonging to the nation and shall pay the contractor the cost recovery and its share of profits in cash on a monthly basis.

These contracts will include an adjustment mechanism for the profit split rates so that the Mexican state “may capture the extraordinary profitability” from production.

#### **iv. Service Contracts**

Under service contracts, contractors will deliver all production to the state, and fee payments shall only be made in cash as established in each contract. Exploratory phase fees and royalties will not apply to service contracts. Payment to the contractor shall be made by the Mexican Oil Fund with the proceeds from the sale of the production derived from the respective service contract.

#### **E. PEMEX PARTICIPATION IN E&P CONTRACTS**

The Hydrocarbons Law establishes that PEMEX may participate in tender processes for E&P contracts (after the Round Zero process) and may freely enter into joint ventures with private parties to participate in those tender processes. Unlike in entitlements migrated to E&P contracts, when PEMEX is granted an E&P contract in a competitive tender process, PEMEX, like any other private party, would be able to directly (without the need for bid process) assign some or all of its rights and obligations under such E&P contract to another party under the terms established by the law.

Pursuant to the Hydrocarbons Law, SENER **may** establish, within the bidding terms of E&P contracts, that PEMEX’s participation in a contract is required in the following cases:

- Where PEMEX has an entitlement that coexists, at a different depth, with an offered contract area;
- Where there are opportunities to foster the transfer of knowledge and technology for the development of the capabilities of PEMEX or another State Productive Enterprise (up to a

maximum 30 percent required participation); and

- For projects that are to be supported by a specialized financial vehicle from the Mexican state, such as the Mexico Oil Fund (up to a maximum 30 percent required participation).

SENER **shall** establish, within the bidding terms of E&P Contracts, that PEMEX is to have a required participation:

- Where there is a possibility of discovering an international transboundary deposit (with a minimum required participation of 20 percent).

#### **F. NATIONAL CONTENT**

The minimum average local content requirement for E&P activities will be 25% by 2015 and will be gradually increased to 35% by 2025. Deep water and ultra-deep water activities may have a lower requirement, as determined by the Ministry of Economy.

The specific percentage of national content required shall be established in the bidding terms of E&P contracts. The Ministry of Economy shall establish the measurement methodology for national content in entitlements and E&P contracts, taking into consideration the following factors:

- the goods and services to be contracted, considering their place of origin,
- the qualified local work,
- the investment in local and regional infrastructure, and
- the transfer of technology.

The entitlements and E&P contracts will include specific penalties for the failure to comply with the national content requirements.

#### **G. INFORMATION FROM E&P ACTIVITIES**

The Hydrocarbons Law establishes that Mexico owns all geological, geophysical, petro-physical

and petrochemical information, as well as the information obtained from geological surveys and E&P activities that are carried out by PEMEX, any Productive State Enterprise or private parties. The CNH will retain, administer and use this information and publish it through the National Center of Information.

PEMEX, any other State Productive Enterprise and all other persons are prohibited from publishing, delivering or obtaining any of the information mentioned in the preceding paragraph by means other than those contemplated in the law or without the CNH's consent.

In addition, PEMEX, its affiliates and the Mexican Petroleum Institute are required to transfer without cost to the CNH all of said information, as well as information obtained from surveys and surface exploration, and information on reserves, to the extent it was obtained before the effective date of the Hydrocarbons Law (August 12, 2014). This transfer must be made within a period of time that shall not exceed two years and shall be conducted pursuant to regulations to be issued by the CNH.

The CNH shall have unrestricted access to PEMEX's and the National Petroleum Institute's facilities, information and assets.

Contractors and State Productive Enterprises are required to deliver to the CNH information obtained in their surveys and surface exploration. The CNH shall keep this information confidential. The CNH may contract with third parties to conduct surveys and subsurface (seismic) exploration.

### III. Midstream and Downstream Sectors

All midstream and downstream hydrocarbon activities may be carried out under permits to be issued by SENER or the Energy Regulatory Commission to any qualified person.

#### A. PERMITS

The following activities will require a permit from SENER:

- Treatment and refining of petroleum;
- Processing of natural gas; and
- Import and export of crude oil, natural gas and petroleum products.

The following activities will require a permit from the Energy Regulatory Commission:

- Transportation, storage, distribution, compression, liquefaction, decompression, regasification, marketing and retail sale of crude oil, natural gas, petroleum products and petrochemicals; and
- Integrated pipeline transportation and storage systems.

The Hydrocarbons Law includes provisions relating to the permit application process, and suspension, revocation and other general terms relating to permits.

Any person who currently engages in treatment, refining or processing activities, and who does not have a permit granted by SENER will need to obtain a permit from SENER under the new law no later than June 30, 2015, to be able to continue such activities.

Any person who currently engages in transportation, storage, distribution, compression, liquefaction, decompression, regasification, marketing and retail sale activities, and who does not have a permit granted by the Energy Regulatory Commission will need to obtain a permit from the Energy Regulatory Commission under the new law no later than December 31, 2015, to be able to continue such activities.

#### B. NATIONAL CENTER OF NATURAL GAS CONTROL

The National Center of Natural Gas Control (CENAGAS) must be established by the executive no later than twelve months after the enactment of the Hydrocarbons Law. CENAGAS

will have, at the outset, a dual function: (i) it will acquire from PEMEX, and own and operate, all of PEMEX's gas transmission pipeline and storage facilities and (ii) it will be the independent administrator of the "National System for the Integrated Transportation and Storage of Natural Gas."

The National System for the Integrated Transportation and Storage of Natural Gas will be comprised of (i) the natural gas transmission pipeline and storage facilities and (ii) compression, liquefaction, decompression, regasification and other related infrastructure owned by CENAGAS or owned by private parties that desire to interconnect to them.

The Hydrocarbons Law contemplates the existence of interconnected transmission and storage systems which shall have their own separate and independent administrators in addition to, and separate from, the National System for the Integrated Transportation and Storage of Natural Gas.

CENAGAS will deliver to SENER, with the technical opinion of the Energy Regulatory Commission, a five-year plan relating to the expansion of the National System for the Integrated Transportation and Storage of Natural Gas. CENAGAS will carry out the tender processes for projects that are considered "strategic" for the nation based on criteria established in the law.

For non-strategic projects, State Productive Enterprises and private parties may carry out infrastructure projects under their sole risk and responsibility. State Productive Enterprises, such as the Federal Electricity Commission (CFE), are required to conduct tender processes to select a third party to develop their infrastructure projects, in which such State Productive Enterprises may be able to reserve for themselves the capacity that is required for their operations.

### **C. OPEN ACCESS AND COMPETITION FOR MIDSTREAM ACTIVITIES**

The Hydrocarbons Law establishes that all permit holders providing transportation, distribution or storage services shall provide open and non-discriminatory access to their facilities, subject to available capacity and pursuant to rules to be issued by the Energy Regulatory Commission.

The Energy Regulatory Commission, with the opinion of the Federal Economic Competition Commission, may establish regulations to promote a competitive energy sector that may include the strict legal separation among activities or the administrative, operational or accounting separation of certain activities.

### **D. RETAIL SALES**

Starting on January 1, 2017, or any time before such date if market conditions allow it, import permits for gasoline and diesel fuel may be granted by the Energy Regulatory Commission.

Starting on January 1, 2016, permits for the retail sale of gasoline and diesel fuel may be granted to any qualified person by the Energy Regulatory Commission.

Regarding gasoline and diesel retail prices, the following shall apply:

- Through the end of 2014, prices will be regulated pursuant to the current regulations;
- Starting January 1, 2015, until December 31, 2017, gasoline and diesel prices shall be established by the Executive Branch by decree, taking into account transportation cost differences between regions and other factors; and
- Starting January 1, 2018, retail prices for gasoline and diesel will be freely determined by market conditions.



#### IV. Anticorruption, Transparency and Penalties

Pursuant to the Hydrocarbons Law, SENER, the Ministry of Finance and the CNH shall publish information on a monthly basis relating to contract areas offered, E&P contracts and entitlements granted, permits approved, oil revenues received by the nation and payments made to contractors, among other information.

The Hydrocarbons Law also contains a specific chapter for anticorruption and transparency, providing that any person (private party or public official) who conducts “corrupt acts” shall be sanctioned. Corrupt acts shall also constitute termination events of entitlements, E&P contracts and permits.

The Hydrocarbons Law includes a chapter establishing specific fines for violations to the law applicable to State Productive Enterprises and private parties participating in the Mexican hydrocarbons sector. Depending on the subject matter, these fines may be imposed by SENER, the Ministry of Finance, the CNH, the Energy Regulatory Commission or the National Agency of Industrial Security and Environmental Protection.

#### V. Land Issues

The Hydrocarbons Law establishes that hydrocarbon activities are public-interest activities which shall prevail over any other activity that requires surface or subsoil use. Accordingly, the Hydrocarbons Law authorizes the establishment of legal easements or the necessary surface occupation or use of privately owned land in connection with the performance of hydrocarbon activities.

The consideration for the purchase, use or occupation of land, goods or rights that are necessary for conducting E&P activities shall be negotiated directly between property owners and the contractors or State Productive Enterprise, as applicable. The Hydrocarbons Law

establishes a detailed process by which such negotiations shall be conducted.

For E&P projects that reach commercial production, property owners may be paid a percentage of the revenues that are related to the contractor or State Productive Enterprise for the particular project, deducting any amounts owed to the Mexican Oil Fund. This percentage shall range between 0.5 percent and 3 percent for non-associated natural gas and between 0.5 percent and 2 percent for all other hydrocarbons.

The Institute of Administration and Appraisals of National Assets (*Instituto de Administración y Avalúos de Bienes Nacionales*), a state entity in charge of administering national assets, shall establish and maintain data regarding the average prices for the use, occupation or purchase of land, which data shall serve as a starting point for subsequent negotiations.

Any agreement reached by the parties shall be submitted by the contractor or State Productive Enterprise to the competent district judge of civil matters or unitary agrarian judge for examination and, if applicable, validation.

If the parties do not reach an agreement within 180 days, the State Productive Enterprise holding an entitlement or the contractor holding an E&P contract, as applicable, may (i) request a district judge of civil matters or unitary agrarian judge to grant a “legal hydrocarbon easement” or (ii) request the Institute of Administration and Appraisals of National Assets to conduct a mediation pursuant to a specific process established in the same law. If the parties do not reach an agreement after such mediation, SENER shall then propose to the executive branch the establishment of a legal hydrocarbon easement.

The legal hydrocarbon easement established by the Hydrocarbons Law is a new legal concept under Mexican Law that can be established judicially (by a competent judge) or administratively (by the executive branch).

The legal hydrocarbon easement comprises the following rights:

- Transit right of persons;
- Transportation, handling and storage of all kinds of construction materials, vehicles, equipment and goods; and
- Construction, installation and maintenance of infrastructure or carrying out works necessary for the development or monitoring of the activities contemplated in an entitlement or E&P contract.

The legal hydrocarbon easement shall not exceed the duration of the respective E&P contract or entitlement. The Hydrocarbons Law provides a mechanism to establish the consideration for each legal hydrocarbon easement.

## VI. Social Issues

In regard to social issues, the Hydrocarbons Law establishes that, prior to the granting of any entitlement or bid publication for an E&P contract, SENER, in coordination with the Ministry of Interior (*Secretaría de Gobernación*) and other competent authorities, shall conduct a social impact study in regard to the relevant area. The results of such study shall be made available to the entitlement holder or bid participants. SENER shall inform entitlement holders and bid participants about the presence of vulnerable social groups in the corresponding areas, with the stated purpose of protecting the rights of those groups. In addition, SENER, in coordination with the Ministry of Interior, shall carry out a consultation process and any other necessary activity to protect the rights of vulnerable social groups, with the objective of reaching agreements with social groups or, if applicable, their consent under applicable law.

SENER may establish, in entitlements or in bid terms, the amounts and other obligations that an entitlement holder or contractor shall contribute for the sustainable development of local

communities in the areas of health, education and labor, among others.

In addition, E&P contractors, State Productive Enterprises and persons interested in obtaining a permit for midstream and downstream projects shall deliver to SENER a social impact evaluation regarding the impact of their proposed activities, as well as the corresponding social plans and mitigation measures.

## VII. Environmental Issues

The Hydrocarbons Law does not regulate environmental matters, which will be addressed by upcoming environmental laws and regulations. The Hydrocarbons Law generally provides that all parties engaged in hydrocarbon activities will prevent and repair environmental damages caused by their activities, and, to the extent declared responsible of violations by competent authorities, they will bear the repair costs pursuant to applicable laws.

The National Agency for Industrial Safety and Environmental Protection, to be created under accompanying legislation, will issue the rules regarding safety and environmental matters.

## VIII. Selected Tax Provisions

The Hydrocarbons Revenues Law establishes the following selected tax provisions applicable to hydrocarbon activities:

- A “permanent establishment” for income tax purposes is created when a non-resident company carries out oil and gas activities in Mexico for more than 30 calendar days in any 12-month period;
- Salary payments to non-resident employees paid by a non-resident employer without a permanent establishment in Mexico for services rendered in Mexico related to oil and gas activities for more than 30 days in any 12-month period are subject to individual income tax payments;

- Companies and consortiums are permitted to hold more than one E&P contract (no ring-fencing);
- New tax applicable to E&P activities consisting of: (i) 1,500 Mexican pesos (having a current value in US dollars of approximately \$114) per square kilometer of contract area during the exploratory phase and (ii) 6,000 Mexican pesos (having a current value in US dollars of approximately \$455) per square kilometer of contract area during the production phase. The tax proceeds will be distributed to the new “Fund for Hydrocarbons Producing States and Municipalities” with the primary objective of repairing any harm caused by E&P activities to the environment and infrastructure of the states or municipalities.

It is important to note that, under the 2014 tax reform in Mexico, holding companies are generally no longer permitted to file consolidated tax returns.

In addition to the tax provisions contained in the Hydrocarbons Revenues Law, persons carrying out hydrocarbon activities will be subject to the ordinary Mexican tax laws.

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**Endnotes**

<sup>1</sup> Starting from 2011, PEMEX conducted three bidding rounds, known as the “Southern Mature Fields,” “Northern Mature Fields” and “Chicontepec” rounds, awarding a total of 15 Integral Exploration and Production Contracts. Prior to 2008, PEMEX awarded a series of Financed Public Work Contracts to contractors primarily for natural gas development in northern Mexico.

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