Mexico’s Energy Reform

November, 2014
Fundamental Principles of the Energy Reform

1. Hydrocarbons in the subsurface belong to the Nation.
2. Free market access and direct and fair competition amongst state-owned enterprises and private companies.
4. Transparency and accountability.
5. Sustainability and environmental protection.
6. Maximizing the State’s revenue for the Nation’s long-term development.
New Institutional Arrangement

- The institutional framework is modernized with the creation of specialized entities, the strengthening of existing ones, the enactment of clear rules, the definition of specific mandates and enhanced interaction between entities to ensure **checks and balances**.

- An intergovernmental **Coordinating Council of the Energy Sector**, chaired by the Secretariat of Energy, will issue recommendations and approve coordination mechanisms to ensure the fulfillment of Mexico’s energy policy.

- **PEMEX** becomes a **State Productive Enterprise (SPE)**.
Entitlements and Contracts

Entitlements
- Awarded to Pemex in Round 0.
- Exceptionally awarded to State Productive Enterprises (SPEs) in the future.
- New competitive fiscal regime.

Exploration and Extraction Contracts
- The State may sign contracts with SPEs or with private companies through the CNH.
- Administrative termination due to major contract breach. International arbitration will take place following the Mexican legislation and in Spanish.
- Booking of expected economic benefits will be allowed for accounting and financial purposes, every contract shall clearly state that hydrocarbons in the subsurface belong to the Nation.
- The State may mandate direct participation in three cases: (1) when fields coexist, (2) to promote technological transfer, and (3) when it has an economic interest to participate through a Special Purpose Vehicle (SPV). For cases (2) and (3), maximum of 30% participation will be established.
- Mining concessionaires will be able to obtain a contract (without a bidding process) to extract coalbed methane stored in carbon mines already in production.

Trans-boundary Hydrocarbon Reservoirs
- SPEs will participate with a minimum of 20% in contracts for areas where trans-boundary reservoirs may exist.
- When trans-boundary resources are confirmed, bilateral treaties will apply.
The Mexican State’s Bidding Rounds: Contractual Process

1. Contract design
   - Selection of contractual areas
     - With technical support from:
       - **SENER**
         - SECRETARÍA DE ENERGÍA
       - **CNH**
         - Comisión Nacional de Hidrocarburos
   - Technical design (incl. local content requirements)
   - Economic-fiscal terms
     - **SHCP**
       - SECRETARÍA DE HACIENDA Y CRÉDITO PÚBLICO

2. Bidding process
   - Bidding process guidelines
   - Data rooms and bidding rounds
     - **CNH**
       - Comisión Nacional de Hidrocarburos
   - Award and contract signing
     - **CNH**
       - Comisión Nacional de Hidrocarburos

3. Operation
   - Technical approval of exploration and development plans
   - Authorization of surface exploration and well-drilling
     - **CNH**
       - Comisión Nacional de Hidrocarburos
   - Management of contracts
     - **CNH**
       - Comisión Nacional de Hidrocarburos
   - Environmental and industrial safety regulation and oversight
     - **ANSIPA**

4. Oil income management

The Mexican Petroleum Fund for Stabilization and Development will be in charge of paying amounts due on contracts and managing State oil revenues.
The Mexican State’s Bidding Rounds: Farm-outs

1. Migration from entitlements to contracts
   - Migration request
   - Farm-out feasibility assessment
   - Definition of the contract’s fiscal terms
   - With technical support from:
     - SENER
     - CNH
     - SHCP

2. Bidding process
   - Pre-qualification
     - Simple, non-binding opinion about the pre-qualification process
   - Data rooms and bidding rounds
   - Award and contract signature
     - CNH

3. Operation
   - Technical approval of the exploration and development plans
   - Authorization of surface exploration and drillings
   - Contract technical management
     - Environmental and industrial safety regulation and oversight
     - ANSIPA

4. Oil income management
   - The Mexican Petroleum Fund for Stabilization and Development will be in charge of paying amounts due on contracts and managing State oil revenues.


1. Migration request

- Migration request
- Current contractor
- Issues guidelines that apply to the process
- Issues simple, non-binding opinion
- Contracts technical design
- Design of fiscal terms guaranteeing that the State wins with the migration

2. Formalization

- Declaration of agreement
- Migration approval
- Yes
- No
- Current contract remains in place
- Investment valuation and constitution of an alliance or joint venture
- Contractor to become partner
- Contract signing**

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** The contract is signed with the new alliance or joint venture.
The Hydrocarbons Law is flexible enough to allow the Secretariat of Energy (SENER), with the opinion of the Secretariat of Finance (SHCP) and CNH, to select the contractual arrangement that best fits each project’s characteristics:

- Contracts will be designed according to international practices.
- License and Production Sharing Contracts will be offered in Round 1.
Some Contractual Provisions

- Will be established in each contract’s **terms and conditions**.
- Will be of economic nature, considering government take and work program, aiming to maximize the State’s revenue.

- Will increase from a **25% on average requirement in 2015**, to **35% on average in 2025**, excluding deep-water projects.
- Preference shall be given to Mexican companies that offer similar price, quality and lead time conditions.
The constitutional reform envisioned the **sustainable energy principle** for the Hydrocarbons industry.

Prior to an entitlement or the publication of a call for bids, SENER along with relevant government entities, will carry out a **Social Impact Study**.

Thereafter, **all project developers must submit a Social Impact Assessment** to SENER. When applicable, SENER will conduct **prior, free, and informed consultations** with indigenous communities.

**Negotiations for land surface use and occupation will be carried out between land owners and companies.** The Government will take part when alternative resolutions are needed.

The compensation related to the land use agreement will include payments for rent, land use change, adverse effects, etc.

**When commercial production is achieved, a percentage of the project’s income could be negotiated.** According to the Law, the percentage shall not be less than 0.5% nor more than 3% for non-associated gas, and not be less than 0.5% nor more than 2% in other cases.
Transparency and Accountability

- **Institutional checks and balances framework** (SENER, CNH, SHCP, and the Mexican Petroleum Fund).
- Bidding rounds procedures and results will be announced in **public sessions**.
- The **contracts** and all the information related to the respective **payments** will be **publicly available**.
- **Control systems** to effectively monitor cost recovery.

- All sessions, agreements, and resolutions will be **publicly available**.
- The commissioners will not be allowed to participate in cases where **conflicts of interest** might arise.
- At least two commissioners must be present at the **meetings between regulators and the regulated parties**, and the meeting records must be disclosed.
- **Ethics code** (prohibiting commissioners and staff accepting allowances, travel expenses or gifts).

- **Corporate information will be published according to the Mexican Stock Market Act**, disclosing their financial status as well as that of its affiliates and subsidiaries.
### Fiscal Elements by Contract Type

<table>
<thead>
<tr>
<th>Economic Variable</th>
<th>Production Sharing</th>
<th>Profit Sharing</th>
<th>License Contracts</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Corporate Income Tax</strong></td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td><strong>Surface Rent</strong></td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td><strong>States and Municipalities Taxes</strong></td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td><strong>Basic Royalty</strong></td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td><strong>Signature Bonus</strong></td>
<td>✗</td>
<td>✗</td>
<td>✓</td>
</tr>
<tr>
<td><strong>Economic Variable</strong> (Payment to the State)</td>
<td>✓% of profit oil (In kind)</td>
<td>✓% of profit oil (Cash)</td>
<td>Additional royalty (Cash)</td>
</tr>
<tr>
<td><strong>Cost Recovery</strong></td>
<td>✓</td>
<td>✓</td>
<td>✗</td>
</tr>
<tr>
<td><strong>Adjustment Mechanism</strong></td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
</tbody>
</table>

- Parameters will be defined taking into account the characteristics of each area.
The Mexican Petroleum Fund will receive all oil revenues that accrue to the State from hydrocarbon exploration and extraction activities.

It will be responsible for calculating and executing payments to Contractors.

Payments to the Contractors will be executed automatically, subject to compliance with the Accounting Principles established in the contract.

The Ministry of Finance will review payments only on an ex-post basis.
Round 1 – General Map

Unconventionals

Perdido Area

Southern Deepwaters

Extra Heavy Oils

Shallow Waters

Chicontepec

Mexican Ridges

Pemex’s farm-outs

Pemex’s current contracts

R1 Extraction

R1 Exploration

14
The proposal for Round 1 contains a wide and diverse selection of areas and fields with different characteristics.

The estimated total investment for Round 1, including Pemex’s farm-outs, amounts to **12.6 billion USD per year**, that is, **50.5 billion USD** over the 2015 -2018 period.

<table>
<thead>
<tr>
<th>Type of project</th>
<th>Blocks (number)</th>
<th>Surface (acres)</th>
<th>Volume (MMboe)</th>
<th>4 yr. estimated investment (bnUSD)</th>
<th>Annual estimated investment (bnUSD)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exploration (Prospective Resources)</td>
<td>109</td>
<td>6,400,761</td>
<td>14,606</td>
<td>19</td>
<td>4.75</td>
</tr>
<tr>
<td>Extraction (2P Reserves)</td>
<td>60</td>
<td>641,732</td>
<td>3,782</td>
<td>15.1</td>
<td>3.78</td>
</tr>
<tr>
<td>Farm-outs (2P Reserves)</td>
<td>14 (in 10 contracts)</td>
<td>151,228</td>
<td>1,557</td>
<td>16.4</td>
<td>4.1</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>183</strong></td>
<td><strong>7,193,721</strong></td>
<td><strong>19,945</strong></td>
<td><strong>50.5</strong></td>
<td><strong>12.63</strong></td>
</tr>
</tbody>
</table>
Round 1 – Timeline (tentative)

Terms and Conditions, Contract model and prequalification requirements

Registration for access to the Data Room
Data room opening

New areas and fields
- Shallow Water
- Extra-heavy Oil
- Chicontepec and Unconventional
- Onshore
- Deepwater

Farm-outs
- SW: Bolontikú, Sinan and Ek
- EHO: Ayatsil-Tekel-Utsil
- Rodador, Ogarrio, Cárdenas-Mora
- Kunah-Piklis, Trión, Exploratus

November
December
January
February
March
April
May
Round 1 – Timeline (tentative)

Shallow Water
Extra-heavy Oil
Chicontepec and Unconventional
Onshore
Deepwater


Publication of Terms and Conditions
Participants registration and data rooms opening
Awarding of contracts
Social Impact Assessment performed by SENER
http://reformas.gob.mx/reforma-energetica/

http://www.energia.gob.mx/

http://www.energia.gob.mx/webSener/rondauno/index.html

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Round Zero

As a result of Round 0, Pemex was awarded a balanced and diversified entitlements’ portfolio.

### Reserves and Prospective Resources Awarded to Pemex

<table>
<thead>
<tr>
<th>Type</th>
<th>Volume (MMboe)</th>
<th>Awarded Percentage</th>
<th>Total Percentage</th>
<th>Surface (acres)</th>
<th>Surface (km²)</th>
<th>Reserves to Production Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reserves</td>
<td>20,589</td>
<td>100%</td>
<td>83%</td>
<td>4,203,262</td>
<td>17,010</td>
<td>15.5</td>
</tr>
<tr>
<td>Prospective Resources</td>
<td>23,447</td>
<td>67%</td>
<td>21%</td>
<td>18,013,240</td>
<td>72,897</td>
<td>5</td>
</tr>
<tr>
<td>Conventional</td>
<td>18,222</td>
<td>70.9%</td>
<td></td>
<td>15,935,578</td>
<td>64,489</td>
<td></td>
</tr>
<tr>
<td>Unconventional</td>
<td>5,225</td>
<td>58.8%</td>
<td></td>
<td>2,077,662</td>
<td>8,408</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>44,036</td>
<td></td>
<td></td>
<td>22,216,502</td>
<td>89,907</td>
<td>20.5</td>
</tr>
</tbody>
</table>

- With Round Zero entitlements Pemex will be able to produce **2.5 million barrels per day** for the next **20.5 years**.

- Pemex can participate in all the contract bidding rounds or receive new entitlements (only in exceptional cases).

- Pemex will benefit from both, greater competition and the possibility of establishing key associations with private companies.