

Clients Bulletin

MEXICO'S NEW HYDROCARBONS REGIME

On August 11, 2014, Mexico published a number of laws pertaining to the so-called "Energy Reform", including various laws dealing with the hydrocarbons sector, mainly the Hydrocarbons Law, the Hydrocarbons Revenues Law and the Mexican Oil Company Law.

The Hydrocarbons Law breaks down the activities it governs into two major groups. Exploration and extraction of hydrocarbons and superficial recognition and exploration, on the one hand, and other hydrocarbons industry activities, on the other.

This bulletin will address the main aspects of the new provisions as they relate to oil exploration and extraction.

LEGAL FORMS FOR EXPLORATION AND EXTRACTION

Oil exploration and extraction can take place under two legal scenarios, first, so-called "Assignments" and, second, through exploration and extraction agreements.

ASSIGNMENTS

Grants to PEMEX and Other Government Entities

The Ministry of Economy may grant to the Mexican government oil company, Petróleos Mexicanos ("PEMEX"), or any other governmental productive enterprise, so-called "Assignments" to carry on oil exploration and extraction, with the favorable opinion from the National Hydrocarbons Commission (the "Commission").

The terms and conditions of these assignments can be modified by the Ministry of Energy with the favorable opinion from the Commission.

Such assignments can be transferred to another governmental productive enterprise only, with the prior authorization from the Ministry of Energy.

When the entity receiving the Assignment decides not to continue with the exploration or extraction works, it may renounce the corresponding Assignment, with the approval of the Ministry of Energy, filing a notice to this effect before the Commission.

On the other hand, in certain events the Ministry of Energy can revoke an Assignment and thus

recover the assigned area.

Services Agreements

PEMEX or the other governmental productive enterprises can enter into services agreements to carry on the activities under the Assignments, but exclusively with individuals or with legal entities created under Mexican law.

The law expressly provides that in all events the compensation to the service provider shall be in cash, that is, service providers cannot receive part of the oil production as compensation.

Round Zero

In line with this new mechanism, on August 3, 2014 the Ministry of Economy announced that it had assigned to PEMEX 120 fields covering 71% of the overall oil production and 73% of the overall gas production in Mexico. See the enclosed Ministry of Economy communiqué (in Spanish) listing the assigned fields.

Migration into Exploration and Extraction Agreements

PEMEX and all other governmental productive entities may request from the Ministry of Energy migration of the Assignments they were granted to exploration and extraction agreements. The Ministry of Energy will decide, with technical assistance from the Commission, setting the corresponding economic terms.

EXPLORATION AND EXTRACTION AGREEMENTS

Contracted with the Commission

The Commission is empowered to enter into exploration and extraction agreements, observing the guidelines set by the Ministry of Energy and by the Ministry of Finance and Public Credit.

These agreements must specify, in all events, that the underground hydrocarbons are the property of the Mexican nation.

Bidding Process

Bidding Mandatory – Exception. Selection of contractors for exploration and extraction agreements will be done through bidding processes.

Note that no bidding award is necessary in certain events regarding owners or mining concessions in order to carry on natural gas exploration and extraction activities in the mineral

carbon veins produced under such concession, following certain requirements.

Invitation. The bidding process begins with publication in the Federal Official Gazette of the invitation to bid.

Entities interested in participating in the bid must first comply with the prequalification criteria regarding the technical, financial, performance and experience elements as called for in the guidelines issued by the Ministry of Energy.

Proposals. Proposals may be submitted and analyzed through electronic means in terms to still be specified by the regulations to be issued.

At least 90 calendar days must elapse between the date the invitation is published and the day in which proposals are to be submitted.

Who Can Bid. A distinctive note of the energy reform is that PEMEX ceases to have the oil monopoly and is transformed into an entity similar to a private entity. Consequently PEMEX can also bid for exploration and extraction agreements. This is true for other governmental productive companies as well, who may also participate as bidders.

In addition, only Mexican companies meeting the following requirements can participate in bids:

- They must be resident, for tax purposes, in Mexico.
- Their corporate purpose should be exclusively oil exploration and extraction.
- They should not elect to be taxed under Mexico's new tax consolidation regime

Consortiums, Joint Ventures. Bidders can participate individually or as a consortium or a joint venture ("*Asociación en Participación*").

A consortium is defined as those events where two or more entities file jointly a proposal within the bidding process to be awarded an exploration and extraction agreement. Joint ventures are not defined in the hydrocarbons legislation. However, under commercial law they are defined as those agreements where one of the parties allows a second party, who contributes money or services, participation in the profits and losses of a going concern or of one or more business ventures. The hydrocarbons legislation does provide, however, that only joint ventures entered into pursuant to Mexican law can bid and be awarded these agreements.

Each of the members of the consortium or of the joint venture must meet the requirements mentioned above for bidders and each must sign the agreement awarded.

Alliances and Associations. PEMEX and all other governmental productive entities may enter into alliances or associations to participate in the bidding processes.

Such alliances or associations can be established under any form allowing the greatest

productivity and profitability, including modalities where the parties can share costs, expenses, investments, risks as well as profits, production, and other aspects of exploration and extraction. These alliances or associations will be governed by general contract law.

Excluded Bidders. The Commission is prevented from considering proposals or entering into exploration and extraction agreements with the following individuals or entities:

- Those who have been barred or prevented by a competent authority from contracting with the federal government in accordance with the applicable provisions.
- Those who have grave breaches pending cure under exploration and extraction agreements previously awarded.
- Those who use third parties to avoid the disqualification provisions.
- Those who file false or incomplete information. Where the information is incomplete, the Commission will request the corresponding bidder, for one single time, to complete the submission within a term granted to the effect.
- Those other individuals or entities prevented from bidding in the bid specifications.

Award. The award mechanism may be, among others, an ascending auction, a descending auction or an auction on the first price in closed envelope. In this latter event the envelopes must be submitted and opened in one same public session.

The variables to award exploration and extraction agreements shall, in all events, be of an economic nature, with the goal of maximizing revenues for the Mexican government in order to obtain the largest benefit for the long-term development. Taking into consideration the specific circumstances of each agreement, the Ministry of Finance and Public Credit will establish the minimum amount that will be acceptable for any of the award variations.

The award variations will be negotiated as to the amount or percentage of revenues received by the government as well as the amount that the contractor agrees to invest, where applicable.

Bidding processes must call for tie-breaker criteria, which are to be included in the corresponding bid specifications.

The bidding process should follow the principles of transparency, maximum publicity, equality, competitiveness and simplification.

The bid award must be published in the Federal Official Gazette.

Bid awards can only be challenged through a constitutional-relief procedure (“*amparo indirecto*”).

The Commission is entitled to revoke the decision to award an exploration and extraction bid where it is shown that the information submitted by the awarded individual or entity during the process is false. In this event, the corresponding agreement shall be null and void.

Mexican companies, governmental productive entities, consortiums and joint ventures can be awarded more than one exploration and extraction agreement.

National Content

Activities under exploration and extraction agreements must reach, on average, at least 25% of national content. This percentage will be increased gradually from 2015 up to at least 35% in 2025. Additional revisions should take place every five years thereafter.

Exploration and extraction in deep and ultra-deep waters is excluded from this percentage. The Ministry of Economy, following the opinion of the Ministry of Energy, is to establish the national content percentage in accordance with the characteristics of these activities.

The national content obligation must be met individually and progressively as specified in the corresponding exploration and extraction agreement. The agreement must include a compliance program regarding the national content percentage, including the applicable time terms and stages.

Each specific national content requirement must be included in the bidding specifications and in the corresponding award.

The Ministry of Economy is still to establish the methodology to measure the national content and will verify compliance with the national content percentages in accordance with the corresponding program. To this end, the Ministry of Economy may contract verification with independent third parties.

In order to establish the methodology, the Ministry of Economy will take into consideration, among others, the following concepts:

- Goods and services contracted, considering their origin.
- Mexican labor and qualified labor.
- Training of Mexican labor.
- Investment in local and regional physical infrastructure.
- Transfer of technology.

Where the Ministry of Economy finds that a contractor has failed to meet the corresponding national content percentage, it will inform the Commission, who will impose the penalties called for under the corresponding exploration and extraction agreement.

The national content requirements are without prejudice to the provisions of Mexico's international treaties and trade agreements.

Optional Government Participation

The Ministry of Energy, with the technical opinion from the Commission, may include in the bid specifications participation by the Mexican government through PEMEX, any other governmental productive entity or a specialized financial vehicle from the Mexican government, in the following events:

- When the contractual area being bid coexists, at a different depth, with an area "Assigned" to Pemex or other governmental productive entity.
- When there are opportunities to promote transfer of knowledge and technology for the development of the capabilities of PEMEX or other governmental productive entity.
- In the event fostering a project through a specialized financial vehicle of the Mexican government is desired.

The participation in the last two events cannot exceed 30% of the investment in the project.

The bid's specifications must set forth the manner, terms and conditions in which the above participation right can be exercised.

Mandatory Government Participation

On a somewhat similar note, the Ministry of Energy, with assistance from the Commission, may establish in the bid specifications a mandatory participation by PEMEX or other governmental productive entity in exploration and extraction agreements in those contractual areas where the possibility exists to find cross-border fields.

In these events, the mandatory participation will be of no less than 20% of the investment in the project.

In those events where existence of a cross-border field is confirmed in the contractual area, the provisions of Mexico's international treaties shall apply.

Subcontracting with Foreign Entities

PEMEX, in order to carry on its activities, may enter into agreements, alliances or associations or any other legal act with individuals or legal entities of the private sector, both Mexican and international. This is the provision that will allow PEMEX to directly subcontract with non-Mexican entities.

There is no express provision in the law to the effect that Mexican private entities that are

awarded an exploration and extraction agreement can subcontract with foreign entities. Nonetheless, this follows (i) from the fact that such subcontracts are not prohibited, (ii) from the fact that PEMEX can subcontract with foreign entities, which confirms that participation by foreign entities as subcontractors is not prohibited and (iii) by the fact that the law calls for preference to be given, in like conditions, to Mexican service providers, which also suggests that foreign service providers may be contracted as well.

PEMEX Associations and Alliances

Once oil exploration and extraction agreement has been awarded to PEMEX, PEMEX may carry on the corresponding activities in association or alliance with third parties. This can be done by creating or participating in subsidiaries, through minority participation in other companies or any other form or association.

PEMEX may also participate in joint ventures (*“Asociación en Participación”*) or consortiums through subsidiary-productive enterprises or affiliates.

Again, these associations, alliances, associations, joint ventures or consortiums can be with foreign entities.

Alliances and Associations under Migrated “Assignments”

Similarly, where an Assignment is migrated into an exploration and extraction agreement, PEMEX and any other governmental productive entity can create alliances or associations. In these events, however, the alliances or associations must be with legal entities incorporated under Mexican law.

Selection of the corresponding partner is to take place through a bidding process representing the best conditions for selection and to the best interest of the Mexican nation, following the best transparency practices.

The Commission will carry on the bidding process in accordance with technical and economical guidelines established by the Ministry of Energy and the Ministry of Finance and Public Credit, respectively.

These bids should follow the same rules applicable to exploration and extraction agreement bids, except for the opinion from the Federal Economic Competition Commission.

Once the awarded partner is selected, the Commission will enter into or amend the corresponding exploration and extraction agreement.

Preference

Exploration and extraction agreements shall provide that under the same circumstances regarding prices, quality and timely delivery, preference is to be given to:

- The acquisition of Mexican goods, and
- contracting of Mexican-origin services, including training and hiring, at a technical and directive level, of Mexican citizens.

Accounting and Financial Treatment

Contractors have the right to report, for accounting and financial purposes, the exploration and extraction agreement as well as the expected benefits therefrom, provided the corresponding agreement expressly provides that the underground hydrocarbons are owned by the Mexican state.

On the other hand, persons who enter into agreements with PEMEX shall have no right to register as assets of their own the oil reserves, which are owned exclusively by the Mexican State. Such persons, however, can report the economical interest that the corresponding acts or agreement represent for them.

Types of Agreements

The Ministry of Energy shall, for each contractual area, determine the type of contractual arrangement to be bid. The types of contractual arrangements called for in the law are:

- Service agreements.
- Profit sharing agreements.
- Production sharing agreements.
- License agreements.
- Others.

Service Agreements

Under the oil exploration and extraction services agreements, the contractor is to deliver the entire production to the Mexican government. Compensation to the contractor will always be in cash. Each agreement must stipulate the agreed-upon compensation, considering the standards and uses of the industry.

Payments to the contractor under service agreements will be made by the Mexican Oil Fund with the funds generated from the sale of the contractual production under each service agreement.

Profit Sharing Agreements

These agreements call for the following payments:

- I. To the Mexican government:
 - a. A contractual quota for the exploration phase.
 - b. Royalties.
 - c. A payment calculated as a percentage of the Operating Profit.

- II. To the contractor:
 - a. Recovery of costs incurred.
 - b. The balance of the Operating Profit after the payment to the government mentioned in c) above.

Monthly Contractual Quota. The monthly contractual quota for the exploratory phase corresponds to contractual areas that are not in the production stage and are as follows:

During the first 60 months of the agreement	\$1,150 Pesos per square kilometer
As from month 61 of the agreement	\$2,750 pesos per square kilometer

The value of the monthly quotas will be indexed in January of every year in accordance with the variations in the Mexican national consumer price index of the immediately preceding year.

Royalties. The amount of the royalties is determined by applying the rates below to the agreement price of the oil:

- When the agreement price of the oil is less than \$48 US Dollars per barrel: 7.5%
- When the agreement price of the oil is equal to or greater than \$48 US Dollars per barrel: $[(0.125 \times \text{agreement price of the oil}) + 1.5]\%$

In determining the rates to compute the royalties, consideration is to be given to the effect of the variations in the producer price index of the United States of America, or the index substituting therefor. For these purposes, the Ministry of Finance and Public Credit must follow the guidelines it itself issues, which are to be published in the Federal Official Gazette.

Each and every exploration and extraction agreement must provide that the contractual value of the oil is to be determined every month, setting the mechanism to determine the agreement price at the measuring point, reflecting marketing conditions. Where transactions are carried on with related parties, the mechanisms should consider, as the case may be, the necessary adjustments regarding quality, sulfur content, API gravity and commercialization, transportation

and logistics cost, among others. Further, in transactions between related parties, a transfer pricing study should be prepared following the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations of the OCDE, to the extent they are consistent with the provisions in the income tax law and with treaties entered into by Mexico.

Operating Profit. The operating profit is determined for each monthly period and is the result of subtracting from the Oil Contractual Value the following:

- The amount of the royalties effectively paid by the contractor during the period.
- The amount of the cost recovery mentioned above.

In determining the operating profit, there shall not be deducted the costs and expenses which are not deductible in computing the costs recovery mentioned below.

In order to allow the Mexican government to capture the extraordinary profitability that may be generated by hydrocarbon extractions, the operating profit percentage corresponding to the Mexican government is to be modified through an adjustment mechanism spelled out in the bid specifications.

Costs Recovery. Payment of the amounts corresponding to costs recovery will be equal to the amount of the costs, expenses and investments recognized in accordance with the guidelines set by the Ministry of Finance and Public Credit. For each period, this payment cannot exceed the "Cost Recovery Limitation". Recognized costs, expenses and investments not paid as a result of the Cost Recovery Limitation during a given period, shall be carried forward to and included in the payment corresponding to the cost recovery of subsequent periods.

In determining the cost to be recovered, the following costs and expenses cannot be recognized or registered:

- Financial costs.
- Costs incurred by negligence or fraud from the contractor or the persons acting on its behalf.
- Donations.
- Costs and expenses corresponding to easements, rights of way, temporary or permanent occupation, rental or purchase of land, indemnification and any other similar concept, with certain exceptions.
- Costs incurred for advisory services except those authorized in the guidelines to be issued by the Ministry of Finance and Public Credit.
- Expenses originating from noncompliance with applicable provisions, including those related to risk management.
- Expenses related to training and to training programs not meeting the guidelines issued by the Ministry of Finance and Public Credit.
- Expenses originating from noncompliance with guaranty conditions as well as those

resulting from the purchase of goods that have no guaranty from the manufacturer or its representative against manufacturing defects, in accordance with general practices followed in the oil industry.

- Expenses, costs and investments for the use of technology owned by the contractor, except those having a transfer pricing study in accordance with the income tax law.
- Amounts registered as provisions and fund reserves except those regarding abandonment of the installations in accordance with guidelines issued by the Ministry of Finance and Public Credit.
- Legal costs for any arbitration or dispute involving the contractor.
- Commissions paid to brokers.
- Payments for royalties and for contractual quotas for the exploratory phase under the corresponding agreement, as well as payment of the consideration, expenses, costs and investments corresponding to other agreements.
- Costs, expenses and investments exceeding the reasonable market references or prices, in accordance with the rules and bases regarding registration of costs, expenses and investments provided in the corresponding agreement.
- Those that are not strictly indispensable to the activity subject matter of the corresponding agreement, those specified in each agreement taking into consideration the particular circumstances or situations and those established in the guidelines issued by the Ministry of Finance and Public Credit.

Exploration and extraction agreements will provide that in those events where the contractor sells assets whose costs, expense or investment have been recovered in accordance with the agreement, the sales proceeds are to be delivered to the Mexican government through the Mexican Oil Fund or, if approved by the Ministry of Finance and Public Credit, a like amount will be discounted from the compensation corresponding to the contractor. The contractor has the obligation to inform the Ministry of Finance and Public Credit and the Commission of the above-mentioned sales.

Registration and recognition of costs, expenses, investments and revenues, in accordance with the provisions in the corresponding agreements, shall have effects to determine the payments called for under the agreements only. Such registration and, where applicable, recognition do not imply their acceptance or disallowance for tax purposes.

How Payments are Made. Under profit sharing agreements the contractor must deliver the entire production to the distributor who is to sell the production, mentioned below, who will deliver the sale proceeds to the Mexican Oil Fund.

The Mexican Oil Fund will keep the payments corresponding to the Mexican government and will pay to the contractor the payments it is entitled to for each monthly period as called for under the corresponding agreement.

Production Sharing Agreements

Compensation under these agreements is as follows:

- I. To the Mexican Government:
 - a. The contractual quota for the exploration phase, mentioned above.
 - b. Royalties, computed as mentioned above.
 - c. A payment calculated as a percentage of the Operating Profit, as discussed above.

- II. To the contractor:
 - a. Recovery of costs, as discussed above. However, the corresponding agreement may provide for this payment not to be made.
 - b. The remaining of balance of the Operating Profit after payment to the government mentioned in c) above.

Based on the nature of production sharing agreements, the payments to the contractor will be made in kind, with a proportion of the production equal to the value of such considerations. Similarly, payments to the government mentioned in I b) and c) are paid in kind.

The corresponding agreement must provide that the payments that the contractor is to deliver in kind will be delivered to the distributor in charge of selling the production, who will deliver the sales proceeds to the Mexican Oil Fund in each period called for under the Agreement.

License Agreements

License agreements will call for the following payments:

- To the Mexican government:
 - a. A signing bonus.
 - b. The contractual quota for the exploration phase.
 - c. Royalties.
 - d. A payment determined under the corresponding agreement considering the contractual value of the hydrocarbons.

- To the contractor, sale by the Mexican government of the hydrocarbons, once extracted from the underground, provided that the contractor has complied with all the payment obligations to the Mexican government mentioned above, in accordance with the corresponding agreement.

The Ministry of Economy will determine the signing bonus for each agreement and the amount as well as the payment conditions shall be included in the bid's specifications. The contractor is to pay the bonus in cash, through the Mexican Oil Fund.

The payments in subsections b), c) and d) is to be made in cash in each period called for under the agreement.

In order to allow the Mexican government to be compensated for the possible extraordinary profitability generated by oil extractions, the payment mentioned in d) may be modified through an adjustment mechanism to be included in the corresponding agreement and the corresponding bid specifications.

Flexibility in Determining Payments to Contractors

The Ministry of Finance and Public Credit can elect to include in the exploration and extraction agreements, any of the payment formulas mentioned above or a combination thereof.

Time of Payment to Contractors – No Advances

All considerations to the benefit of the contractor, under any type of agreement, will be paid after the contractor generates the production called for in the agreement. Therefore, as long as there is no contractual production, the contractor will not be entitled, under any circumstance, to the considerations nor shall he be given advances of any kind.

Products and Substances other than Hydrocarbons

Each exploration and extraction agreement must include the conditions under which the contractor may benefit from the products and substances other than hydrocarbons generated in the exploration and extraction, provided no concession is required for their exploitation or benefit.

Sale of the Production through Distributors

Although the oil belongs to the Mexican nation at all times, the Commission is entitled to contract with PEMEX, any other governmental productive entity or a legal entity incorporated under Mexican law, through a public bidding process, to render, for a compensation, services for the sale of the hydrocarbons the government receives as a result of the exploration and extraction agreements.

The distributor must deliver to the Mexican Oil Fund all the proceeds from the sale of the production which, under the terms of each individual exploration and extraction agreement, belong to the Mexican government, after discounting its compensation under the distribution services agreement.

In the beginning, these agreements will be entered into exclusively with PEMEX or another governmental productive entity and must be for a period not exceeding December 31, 2017. These agreements cannot be renewed or extended. Thereafter, beginning on January 1, 2018, distribution contracts may be entered with private Mexican entities as well.

Execution of Works - Authorizations

Contractors must secure approval from the Commission of the exploration plans and the extraction development plan before proceeding with the works. The Commission must issue its approval or denial within 120 calendar days from the date it receives the necessary information. Failure to issue a resolution within this term means that the plans have been approved.

Changes to the exploration plan or the extraction development plan also require approval from the Commission.

Authorization from the Commission is required in order to drill the following types of wells:

- Exploratory wells.
- Deepwater and ultra deepwater wells.
- Model wells used as design models.

Likewise, superficial recognition and exploration activities to investigate the possible existence of hydrocarbons are subject to authorization from the Commission. Authorizations received for these purposes do not grant exploration rights or preferential rights regarding possible exploration and extraction agreements. Contractors do not require this authorization regarding their contractual areas; they must simply file a notice before the Commission and file information and comply with any other obligations established in regulations to be issued by the Commission

Authorizations will terminate upon termination of the corresponding exploration and extraction agreement.

Authorization will lapse if the beneficiaries:

- Do not exercise the rights conferred in the authorization for a period of 120 calendar days from the date the authorization was issued, except where the Commission authorizes the delay for justified cause.
- Where the beneficiaries fall in any other lapsing event called for in the corresponding authorization.

The Commission may revoke authorizations given in any of the following events:

- Where the authorized party does not post or does not keep in force the guarantees, insurances or any other financial instruments required under applicable rules.
- Where the beneficiaries do not comply with the regulations issued by the Commission or with any conditions in the authorization.
- Where the beneficiary does not pay the corresponding contributions and levies for the authorization or extension, where applicable.
- In any other event contemplated in the corresponding authorization.

Assignment of Rights

Prior approval from the Commission is necessary for contractors to enter into alliances or associations whereunder they assign:

- Corporate and administrative control of the contractor.
- Control of the operations in the contractual area, wholly or in part.

In order to authorize assignment of control over the operations, the Commission shall take into consideration, among other aspects, that the proposed operator has sufficient experience, technical and financial capabilities to direct and carry on the corresponding activities and to assume the inherent responsibilities under the exploration and extraction agreements.

Once the assignment is approved, the Commission will make the necessary amendments to the corresponding exploration and extraction agreement. No other terms of the agreement will be deemed amended as a result of the above assignment of rights.

Assignment of rights without the aforementioned approval and without observing all applicable contractual terms shall be null and void.

Where the stated capital of the contractor is amended in a way such that it does not imply a change in the corporate or administrative control, only a notice should be given to the Commissions within 30 days following the change. In the case of companies listed in the Mexican stock exchange, the notice shall be given in accordance with the provisions of the Stock Exchange Law.

Administrative Rescission

The Commission is empowered to rescind, through an administrative declaration, exploration and extraction agreements and to recover the contractual area, only under the following grave circumstances:

- Where the contractor does not begin or suspends the activities called for in the exploration plan or the plan for development of extraction in the contractual area, for more than 180 continuous calendar days without just cause or authorization from the Commission
- Where the contractor does not meet the minimum work undertakings, without justified cause, in accordance with the terms and conditions of the exploration and extraction agreement.
- Where the contractor assigns, wholly or in part, the operation or the rights under the exploration and extraction agreement, without prior authorization from the Commission.
- Where a grave accident is caused intentionally or through negligence of the contractor, causing damage to installations, fatalities and loss of production.
- Where the contractor submits, more than once, intentionally or without justification, false or incomplete information or reports or hides them, to or from the Ministry of Energy, the Ministry of Finance and Public Credit, the Ministry of Economy, the Commission or the National Hydrocarbons Sector Industrial Security and Environment Protection Agency, regarding production, costs or any other relevant aspect of the agreement.
- Where the contractor fails to comply with a binding final decision from the federal courts.
- Where the contractor fails, without justifiable cause, to make any payment or to deliver hydrocarbons to the government, in accordance with the terms and provisions in the exploration and extraction agreement.

Dispute Resolution

Except for the event of an administrative rescission, exploration and extraction agreements can provide for alternative dispute resolution mechanisms, including arbitration in accordance with the Mexican Code of Commerce and the International Arbitration and Dispute Resolution treaties of which Mexico is a party.

The arbitration proceeding shall be governed by Mexican law, shall be carried in Spanish and the corresponding decision shall be based in law and binding and final for both parties.

Contractual Provisions

Exploration and extraction agreements, must include the following provisions:

- Definition of the Contractual Area.
- Exploration plans and development plans for extraction, including the term for the plans to be presented.
- Minimum work and investment program, where applicable.
- Obligations of the contractor, including economic and tax terms.
- Term of the agreement as well as conditions for extension.
- Purchase of warranties and insurance.
- Existence of external audit systems to supervise the effective recovery, where applicable, of the costs incurred and other accounting involved in the operation of the

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agreement.

- Causes for termination of the agreement, including early termination and administrative rescission.
- Transparency obligations allowing for access to the information originating from the agreements, including regulation of the compensation, contributions and payments called for in the agreement.
- Minimum national content.
- Conditions and mechanisms to reduce or return the contractual area.
- Dispute resolution, including alternative dispute resolution.
- Penalties in case of breach of the contractual obligations.
- Liability of the contractor and the operator in accordance with the best international practices. In the event of an accident, the liability of the contractor or operator will not be limited if there is evidence of their bad faith or negligence.
- Observance of the best international practices for operations in the contractual area.

Further, as regards the Mexican Oil Fund and the Ministry of Finance and Public Credit, the exploration and extraction agreements must include the following provisions:

- That administration of all financial aspects of the agreements, related to the payments between the parties and other elements in the law, is to be made by the Mexican Oil Fund.
- That verification of the financial aspects of the agreements regarding the payments between the parties and other elements in the law, is to be done by the Ministry of Finance and Public Credit.
- That the Mexican Oil Fund shall:
 - Receive from the contractor the information and documentation related to the costs, expenses and investments as well as to the deduction of such investments, required to perform under the agreements, and carry a registry of such items and of their recognition, where applicable
 - Receive payment of the royalties, contractual quotas for the exploratory phase and other payments in favor of the Government called for in the agreement.
 - Carry the information registries required to compute and determine the payments between the parties set forth in the agreement.
 - Calculate and pay the payments which, pursuant to the agreement, correspond to the contractors, where applicable.
 - Request the information necessary for the proper exercise of its functions in accordance with the provisions of the agreement.
- That the Ministry of Finance and Public Credit shall:
 - Request from the contractors and third parties the information necessary for the proper exercise of its functions in accordance with the provisions in the agreements.
 - To coordinate with the Commission, in order to receive technical support and to request the latter to carry on field visits or other type of visits to verify the

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activities and investments of the contractors

- To give notice to the Mexican Oil Fund and the Commission regarding the irregularities it detects in performance of the exploration and extraction agreements, in order for the rights of the Mexican Government to be enforced in accordance with the agreements or for the corresponding penalties called for in the agreements to be applied.

Other Contractor Obligations

Contractors are required to comply with the following additional obligations:

- Comply with all terms and conditions in the exploration and extraction agreements and in any authorizations secured.
- Comply with all legal provisions regarding labor, tax and transparency.
- Allow access to their facilities and equipment and facilitate the activities of inspectors and verifiers from the Ministry of Energy, the Ministry of Finance and Public Credit, the Ministry of Economy, the Commission or the Agency.
- Comply with all regulations, guidelines and administrative provisions issued by the Ministry of Energy, the Ministry of Finance and Public Credit, the Commission or the Agency.
- Comply with the guidelines set by the Ministry of Finance and Public Credit and the Commission regarding exploration and extraction agreements.
- Be accountable regarding industrial, operational and environmental security, being responsible for waste, hydrocarbon spills and other resulting damages, in accordance with applicable law.
- File notice before the Ministry of Energy, the Commission or the Agency as well as other competent authorities regarding any accident, event or contingency which, as a result of their operations, endangers the life, health and public security, the environment, the security of the installations or the production of hydrocarbon, and apply the corresponding contingency plans, emergency measures and contention actions in accordance with their liability, under the terms of applicable regulations. To this end, they must file the following:
 - Within ten calendar days from the date of the corresponding accident, a report of events as well as the measures taken to control them as called for under the corresponding regulations, and
 - Within 180 calendar days from the day of the corresponding accident, event or contingency a detailed report regarding the causes giving rise and the measures taken to control and, where applicable, remedy the situation, in accordance with the applicable regulations.
- Provide all required assistance to the competent authorities in the event of emergency or

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accident, as called for in the corresponding exploration and extraction agreement.

- Comply timely and in form with all information and report requests from the Ministry of Energy, the Ministry of Finance and Public Credit, the Ministry of Economy, the Commission, the Mexican Oil Fund for Stabilization and Development, and the Agency.

In addition, contractors must also comply with the following obligations:

- To fund their activities.
- To deliver to the Mexican Oil Fund the payments to the benefit of the Mexican government under the terms of the corresponding agreements, where applicable.
- In the event of agreements including as part of the payment to the contractor the recovery of costs, expenses and investments, to observe the rules and bases included to the effect in the agreement. Such rules and bases are governed by the guidelines issued by the Ministry of Finance and Public Credit.
- To follow the rules and bases regarding procurement of goods and services for the activities carried on under the agreements, included in each such agreement. Such rules and bases are to be governed by the principles of transparency, economy and efficiency in accordance with guidelines issued by the Ministry of Finance and Public Credit.
- To comply with information requests from the various institutions, as required by law.
- To pay the dues and levies established for the administration and supervision of the agreements or for supervision and surveillance of the activities carried thereunder, performed by the Commission by the National Hydrocarbon Sector Industrial Security and Environmental Protection Agency.
- To comply with the obligations regarding abandonment and dismantling in accordance with applicable legal provisions and the provisions in the corresponding agreement, and to transfer to the government the assets generated or required under the agreement, without any charge, payment or indemnity, in good condition and operation, considering the normal wear produced by use, without prejudice to the corresponding hold harmless

When the Ministry of the Treasury and Public Credit changes the guidelines mentioned above, the changes will only apply to agreements entered into after such changes take place.

Each agreement shall expressly include the undertaking of the contractor to stipulate with third parties with whom operations related to the purpose of the agreement are carried on, the obligation of the third parties to file directly with the Mexican Oil Fund, the Commission and the Ministry of Finance and Public Credit, upon request, any information regarding their operations with the contractor under the corresponding exploration and extraction Agreements.

Excluded Zones

The President of the Republic, following the recommendation from the Ministry of Energy, may reserve excluded zones in the areas where the government considers that hydrocarbon

exploration and extraction activities should be prohibited, and to remove areas from such restriction.

No exploration and extraction agreements will be issued for the protected natural areas.

Choice of Law, Forum

All domestic conflicts in which PEMEX or its subsidiary productive enterprise are a party, of whatever nature, must be heard by Mexican federal courts.

As an exception, in the event of legal acts or agreements with effects outside of Mexico or performed outside of Mexico, PEMEX and its subsidiary productive enterprise may agree on the application of foreign law, submit to the jurisdiction of foreign courts regarding commercial matters and enter into arbitration agreements.

Hydrocarbons Exploration and Extraction Tax

A new tax is established for hydrocarbon exploration and extraction activities. This tax is to be paid by contractors who enter into exploration and extraction agreements with the Commission.

The tax is levied at the following rates per square kilometer of contractual area:

Exploration phase: 1,500 Pesos.

Extraction phase: 6,000 Pesos.

The above rates will be adjusted annually, on January 1.

Computation of the tax is done up to 1/100 of kilometer. The tax is payable per month or fractions of a month, on the 17th day of the month immediately following the month for which the tax is being paid.

For purposes of this tax, the exploration phase is defined as the phase from the date the exploration and extraction agreement is formalized up to the beginning of the extraction phase. The extraction phase, in turn, begins upon commencement of the activities destined to the commercial production of hydrocarbons and ends upon termination of the corresponding agreement.

No tax is payable where the contractor evidences that it is prevented from carrying on the exploration and extraction activities in the contractual area. The Mexican tax administration ("SAT") will issue administrative rules regulating this exemption.

Income Tax and VAT

Special provisions have been enacted regarding some income tax and value added tax aspects for entities involved in exploration and extraction activities. We will address the tax regime in a separate bulletin.

CONTACT INFORMATION

For further information and questions, please feel free to contact us.

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