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Why Mexico needs a 2nd national oil company

A state-majority owned company for offshore exploration

DURING THE Q&A OF THE MEXICO DEEP-WATER PANEL that was held on May 4 at the Offshore Technology Conference (OTC) 2017 in Houston, a member of the audience remarked that "there are two elephants in the room: deep-water safety and Pemex as an agency of the Mexican government." The speaker noted that Pemex is not a member of the Center for Offshore Safety and that the hydrocarbon safety agency, ASEA, is still in the start-up phase. With Pemex as a state agency, its executive team is made up of presidential appointees, its budget is controlled by the Finance Ministry and its strategy shaped by the Energy Ministry. The panelist with Statoil observed that in 1972 his company had been restructured as a mixed-capital enterprise, with 66% government ownership.

Company Number	Company Name	Start Date	Address
03227	PEMEX USA GOM I, Inc.	3/19/2012	1209 Orange Street Wilmington, DE 19801

The advantages of a Statoil-type oil company for Mexico are immense. Statoil operates successfully in dozens of countries but Pemex in only one. Pemex itself has been thinking about ventures outside Mexico at least since the presidency of Felipe Calderón (2006-12), but no actual programs or strategy have materialized. Pemex has an affiliate with legal domicile in the United States registered with the Bureau of Ocean Energy Management (BOEM). (See insert.)

In this Public Policy Perspective, we propose a sequence of steps that would create a Pemex 2.0 (or "Pemex-B") as a "State Productive Enterprise" with a mixed-equity capital structure, professional management, and exploration assets selected from Pemex's and the government's portfolios. Shares could one day be sold in an Initial Public Offering *(IPO).*

Contents

Attached to the report is a bilingual glossary of terms that pertain to Pemex subsidiaries, state enterprises and asset transfers.

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SUMMARY

THE MEXICO PANEL at the Offshore Technology Conference (OTC) on May 4, 2017, asked about what would be needed for Mexico to bring about a renaissance in deep-water drilling on a scale that would motivate oil and service companies to set up, or expand, operations in Mexico. The consensus was that the availability of acreage should be increased in a timely manner, a polite way of saying that the schedule of lease auctions for deep-water blocks is too slow.

Panelists did not make any recommendations about how the pace of deep-water lease auctions could be increased. There was one hint of such a recommendation, however, in the remark of the panelist with **Statoil** who reminded the audience that in 1972 his company had been restructured as a mixed-equity enterprise the shares of which are publicly traded and of which the Norwegian government today owns 66%. Implicitly, the speaker was suggesting that Mexico consider that same structure for a national oil company.

This report asks about the desirability and legal and political feasibility of such a structure for a national oil company in Mexico could address the specific issue of increasing the pace of deep-water leasing and drilling in Mexico's portion of the Gulf of Mexico. Here's what we find:

1) The Hydrocarbon Act of 2014 speaks of the possibility of multiple State Productive Enterprises (acknowledging that Pemex presently is the only such oil company);
2) The Act also provides that one such state enterprise may transfer assets (understood as oil and gas leases) from its portfolio only to that of another such state enterprise;
3) A state enterprise may ask that the legal status of a legacy lease (*asignación*) be changed so that it could be the object of a farmout or joint venture.

For a Statoil-style oil company to exist in Mexico, legal and regulatory changes would have to take place:

1) The Hydrocarbon Act would have to create the figure of a mixed-equity national oil company that would also be a State Productive Enterprise.
2) The government creates, by decree, the new company and would need to provide seed money to recruit an executive team.
3) The new team would select blocks from both Pemex's and the government's portfolio to be transferred to create its own asset portfolio.
4) The company would have the mandate to find a qualified oil company to serve as the operator of a given lease (under terms approved by the regulator but without a public auction).

The expectation is that the new company (Pemex-B) would be able to evaluate and rank prospects and find appropriate partners who would serve as operators at a pace faster and with greater confidence than can been done following the regular procedures of public auctions. In one sense, the company would be acting in parallel to the regulator, and, functionally, performing the same task of getting deep-water acreage under contract. At the same time, the company is preparing itself to enter into ventures outside Mexico, first as a non-operator and eventually as an operator. At a future point, it should be able to raise capital from investors through an Initial Public Offering (IPO).

INTRODUCTION

IN THIS SECTION, we identify the need in Mexico for a national oil company that has a mixed-capital structure with professional management and deep-water assets which would have to be transferred from the current portfolios of Pemex and the government.

We then turn to the terminological complexities that were introduced in the Energy Reform of 2013-14. Of central concern are the concepts of "Productive State Enterprise" (*Empresa Productiva del Estado*), "asset" (*asignación*), "*transfer*" (cession) and "working interest" (*interés en participación*).[1]

Later, we shall examine the political, legislative and financial measures that would be needed to create a second national oil company in Mexico (which we refer to as Pemex-B).

Why and how of an oil reform in exploration and production?

In 2004, Pemex produced about 3.4 million daily barrels (MM b/d) of hydrocarbons, while, 10 years later production had fallen to 2.5 MM b/d, and in December of 2016 output seemed headed below 2.0 MM b/d (later recovering slightly to 2.2 MM b/d).

The constitutional amendments of December 20, 2013, changed the legal and regulatory landscape in both hydrocarbons and electricity. The amendments, which allowed for private oil production in Mexico after more than 50 years, were evidently motivated by the specter of a spiraling decline in oil production, exports and tax revenue.

It would be an upgraded National Hydrocarbon Commission (CNH) that would be assigned the role promoting private investment in prospective and producing acreage through the instrument of public auctions. By the beginning of 2017, CNH had conceived of its mandate as covering four asset classes:

1) Deep water
2) Shallow water
3) Onshore conventional
4) Onshore nonconventional.

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[1] In looking into how terms are used and defined, we made good use of our Lexical Database of Mexico's Energy Sector. In a separate report (MEI 847) we shall provide a bilingual glossary of relevant terms and their definitions.

Of these asset classes, it is in the deepwater where "elephants" are likely to be found; that is, reservoirs larger than 500 million barrels of recoverable hydrocarbons. The OTC panelists emphasized that Mexico needs the discovery of such reservoirs not only for oil supply and tax revenue but as much for the enthusiasm that such discoveries would create in the minds of oil and service companies that were not yet committed to the Mexican market.

From this vantage point, the discovery of deep-water reservoirs has a priority above discoveries that may take place either in shallow water or onshore. By CNH's schedule, however, there will be an auction for each asset class only once a year (shallow water and onshore conventional in the spring, deep-water and non-conventional in the fall). The first deep-water auction was held on December 5, 2016, and 11 blocks were offered, 10 from the government's portfolio, just one from Pemex's.

CNH's pace of leasing of deep-water blocks is too slow

Members of the deep-water panel at OTC were unanimous in their perception that CNH's pace of lease auctions for deep-water leases is too slow. While the call for "an average of 20 wildcat wells a year" may have been an exaggeration, inserted in the slides for dramatic effect, there was agreement among the panelists that Mexico's deep water needs "activity, activity, activity," as another panelist put it.

How to increase the pace of leasing and joint ventures in Mexico's deepwater?

There would seem to be three answers to this question:

1) Allow CNH to hold deep-water leases semi-annually (according to industry interest) to include blocks from the government's portfolio as well as from Pemex's.[2]
2) Change the rules so that Pemex could select its own partners for acreage in its portfolio without public auction, and, in this manner, conclude farmout agreements quickly.[3]
3) Create a second national oil company (Pemex-B) that would have professional management, both government and private equity, and the mandate of which would be focused on deep-water blocks in the Gulf of Mexico. The portfolio of assets of this company would be selected from both the government's portfolio as well as that of Pemex's.

The awkward part of the first-listed choice is that CNH's staff is currently responsible for recommending to the Energy Ministry blocks for auction in all four asset-classes. By its own admission, CNH does not have the staff to evaluate and rank deep-water prospects on a large scale.[4]

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[2] Oil companies need sufficient time to evaluate the data to identify opportunities that they may wish to pursue. The evaluation of deep-water prospects on the Mexico's side is made problematic by the absence of analogues and wells. This process should not be rushed.

[3] Pemex first spoke publicly about its desire for farmout agreements in July of 2014, but its first actual agreement was not until December 2016.

[4] In its presentation in Houston on March 9, 2017, CNH officials asked the audience to nominate blocks for leasing, also providing the technical basis for the recommendation.

The second-listed choice should have been policy from the beginning, but such is the public distrust of the corporate culture of Pemex and of the leadership of its labor union that the universal practice of a company choosing its own partners was disallowed in the hydrocarbon law.

The third-listed choice has never been publicly considered in Mexico. The advantage would be that it could hire staff to focus initially just on deep-water opportunities in the blocks that would be transferred to its portfolio by Pemex and the government. Having identified attractive prospects, it could efficiently seek qualified partners to serve as operators.

Benefits of a mixed-capital, national oil company

The speaker from Statoil remarked that his company had been founded in 1972 as a private limited company owned by the Government of Norway. Had the speaker chosen to enumerate the benefits that both his company and his country had received from a mixed-capital structure for its national oil company, the top half-dozen might have been these:

1) a change in corporate culture to one with an entrepreneurial drive for commercial success, a huge shift in mindset from the earlier culture of a career civil servant; today, we strive to raise our performance level in order to compete with partner and workplace peers;
2) a Board of Directors and professional managers who are less influenced by politics; public confidence in the qualifications of our executives and an appreciation of the jobs and suppliers that our success has created at home in Norway;
3) equity and debt financing by the market;
4) next-day feedback (registered in the movement of the price of a share on the stock market) of the wisdom of administrative, personnel and capital decisions; as well as financial and operational results, including the discipline of adherence to international accounting standards;
5) the ability to enter into joint ventures with other oil companies as peers in ventures around the world, thus gathering a diversity of exposure unavailable to a Mexico-only company;
6) a workforce that a) is 100% bilingual in English b) participates in co-ventures with transnational companies, and c) benefits from a diversity of geological, engineering, legal, operational and cultural experiences.

Pemex today enjoys none of these benefits. Instead, Pemex is a government company confined to one country that relies on sovereign guarantees for the financing of its debt and the management team of which is vulnerable to political (i.e., presidential) disruption at any time.

How a new oil company can succeed: Kosmos Energy

Over the course of more than 70 years, the Mexican government has invested generations of political capital in the idea of “strengthening Pemex.” The Energy Reform of 2013-14 indeed strengthened Pemex by allowing it to take on the role of a non-operator in leases that it had received in the government's allocation of blocks that took place in 2014 under the title of "Round Zero." By a stroke of a pen, Pemex was granted exploration assets at no cost.

Things start and end differently in private markets. We may take the example of Houston-based **Kosmos Energy,** which was founded in 2003 by experienced professionals whose idea was to look for oil in areas that had been neglected by major oil companies. With private financing, the company's exploration team imagined an opportunity in an offshore basin in Ghana, acquired a lease and discovered the deep-water Jubilee field, with reserves of upwards of 600 million barrels of oil equivalent (BOE). The field was brought into production in 2010, just 42 months after discovery (a record), and has since produced more than 100 million BOE.[5]

In 2011, the company launched its initial public offering (KOS) on the New York Stock Exchange.

Petróleos Mexicanos o ***las demás empresas productivas del Estado,*** **únicamente podrán** ***ceder una Asignación*** **de la que sean titulares, cuando el cesionario sea otra** ***empresa productiva del Estado*****,**

For Pemex and the Mexican government and legislators, the lesson is that opportunities and rewards that exist abroad with the right management team and capitalization, are also available at home.

The new vocabulary of the energy reform

In the constitutional amendments that were promulgated on December 20, 2013, the neologism *Empresa Productiva del Estado* ("Productive State Enterprise") was introduced but not defined. It appears in the Hydrocarbon Act of 2014 forty-two times. Another undefined term is *asignación*, which appears 66 times in the same law. In some places in the law, one undefined term is used to define another (see insert).

We learn in Article 2 of the Pemex Restructuring Act of 2014 (*Ley de Petróleos Mexicanos*) that Pemex is now no longer an *organismo parastatal* (independent state agency) but an asset that is owned exclusively by the Federal Government.

For the purposes of this discussion, the important points are that an *asignación* is a petroleum property (or legacy block), the commercial rights to which had been assigned to Pemex in the earlier legal regime, and that Pemex would be able to transfer a property only to another Productive State Enterprise (Art. 8).

We need not define *Empresa Productiva del Estado* beyond two features:

1) It is the 100% working-interest title holder of petroleum properties that may be nominated for conversion to an object of a lease auction that, by law, would be conducted by the National Hydrocarbon Commission (CNH), and that, as a result of such an auction, its working interest may be reduced. The Trion auction held on December 5, 2016, would be

[5] The median time between a deep-water discovery and first oil production might be 6 years, while the average would be closer to 8 years.

a case in point. Pemex would have a working interest of 40% in a joint venture with **BHP Billiton**.

2) The company may participate in auctions held by CNH as a bidder, either alone or in association. The successful joint bid with **Chevron** and **Inpex** for a block in the Perdido Area would be an instance of an exercise of this new legal attribute.

What these new attributes do not overcome, however, are the limitations imposed by Pemex retaining the status—as the questioner at OTC pointed out—of a government agency whose executives come and go (on an average of once every three years) at the pleasure of the president of Mexico. As a government agency, all its obligations carry an implied sovereign guarantee of repayment.[6]

As a government agency, it has a public sector labor union that enforces a regime of over-staffing by as much as 50,000 positions. Its employees are civil servants subject to an oversight regime that is known to be arbitrary and unfair in its sanctioning of employees of Pemex and its marketing affiliate, **PMI Comercio Internacional** (PMI).[7] The threat of arbitrary sanctions restricts risk-taking in exploration and trading, as well as in other areas.

The capital budget of a Productive State Enterprise is set by the Finance Ministry and its strategic plans are either set by or approved by the Energy Ministry. As a government agency, Pemex cannot operate outside of Mexico.

Pemex's iconic status in Mexico's populist culture makes private participation in its equity structure politically impossible.[8] Protesters in the street would remind legislators that "Pemex is the property of all Mexicans."

BACKGROUND

THE SUBJECT OF "PRIVATIZING PEMEX" has been in Mexico's political discourse since the early 1990s, but most often as a commitment by a political candidate to *not* privatize Pemex. As the sitting governor of Guanajuato in 1999, Vicente Fox, a speaker in a program sponsored by the prestigious Council on Foreign Relations in New York City, affirmed that were he president he would privatize both Pemex and CFE (the acronym of the state power company). Once he was a presidential candidate, however, his campaign promise was exactly the opposite: he would *not* privatize Pemex or

6 Such a guarantee creates the effect of a State subsidy in the financial market of upwards of 400 basis points.

7 *El Economista*. "Exfuncionaria acusada de defraudar a Pemex se defiende," May 24, 2010. In 2010-2011 there were sanctions imposed on employees of Pemex and PMI, resulting in a loss of employment. On appeal, all of these sanctions were reversed by an administrative court and the terminated employees were given back-pay and the option to be rehired by Pemex. (There is one fired PMI employee, Karen Miyasaki, whose case has not yet been appealed. See cited press article.)

8 The energy reform of 2008 created the investment vehicle of "citizen bond," but it was never used.

CFE. In the background of his campaign posters, there would often be seen the logo or an image associated with Pemex or CFE.

Such was the popular mandate for change, in the beginning of his six-year term in 2006, that President Fox could have called for an energy reform that would have either privatized Pemex or created a second national oil company that would have had a mixed-equity structure. Unfortunately, he did neither. His government devised only a politically timid investment vehicle by which an oil company would be paid for the incremental production of natural gas not by volume and the current market price of gas (which would be expected), but in relation to a price schedule of activities.[9] There would be no energy reform during his presidency, and major oil companies made it clear that they would not work in Mexico as contractors to Pemex.

The next president, Felipe Calderón (2006-12), understood that oil companies needed to be involved both in oil and gas; but, absent a constitutional change (or so it was said), which the PRI opposed, the successes of the Energy Reform of 2008 were few. One notable success was the creation of an agency of public oversight of Pemex, the limited mandate of which was to advise the Energy Ministry on matters related exclusively to Pemex. This agency, the National Hydrocarbon Commission, would come to serve the PRI administration as the *sine qua non* of the upstream reform.

Blocked by domestic politics, Calderón pursued an international agenda, completing a Transboundary Hydrocarbon Agreement with the United States that was signed on February 20, 2012. Pemex also lay the legal groundwork for international operations beyond those associated with trading, including the creation of companies with legal domiciles in the United States.[10] (See insert.)

Pemex E&P looks abroad

Pemex Exploration & Production (Mexico)
which owns
P.M.I. Marine, Ltd. (Ireland)
which owns
Pemex USA, Inc. (United States)
which owns
Pemex USA GOM I, Inc. (United States)

It would be Enrique Peña Nieto (2012-2018) of the PRI who would restore the government's legal authority to issue petroleum leases independently from Pemex. The Energy Reform of 2013-14 would not privatize Pemex, but would give it new legal attributes that simulated those of an oil company, such as the ability to enter joint-equity relationships with other oil companies.

9 The contract was prohibited from producing crude oil, which was considered too politically sensitive at the time.

10 https://www.sec.gov/Archives/edgar/data/932782/000119312516694014/d130274dex211.htm

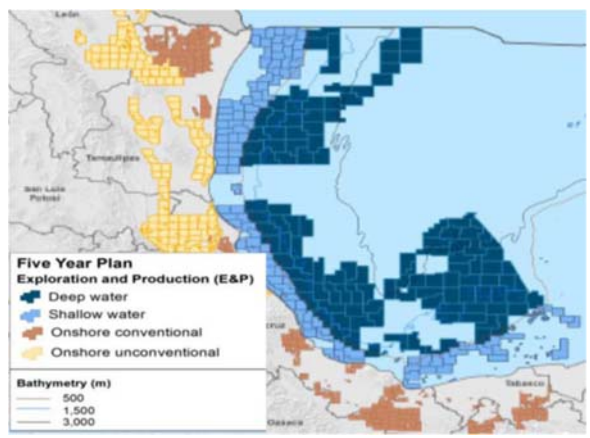
DISCUSSION

IN THIS SECTION, WE OUTLINE A COURSE OF PUBLIC POLICY that would lead to the founding of a mixed capital company that is state-majority owned with private equity and professional management. The company would be dedicated strictly to non-producing, high-quality exploration blocks in Mexico's portion of the Gulf of Mexico. [11] Once founded with an experienced executive team, shares in the company could eventually be offered in an Initial Public Offering (IPO).[12]

The purpose of Mexico's having a second national oil company of this kind is to increase the value of exploration acreage currently held by Pemex and State in ways that are superior to those currently available in the existing legal and regulatory regimes.

Regarding non-producing, exploration blocks, what's wrong with the current regimes?

1) The political clock is ticking faster than the pace of public auctions of government- or Pemex-held blocks. According to panelists at OTC on May 4, for a robust supply regime to be established in the deep-water areas of Mexico's portion of the Gulf of Mexico, 20 wildcat wells a year will be needed. This level of activity will not be achieved anytime soon with a schedule of just one deep-water auction round a year.



2) The Energy Ministry has a "five-year plan" with acreage that could take upwards of a decade to auction at the current pace (see map).

3) Having Pemex-A (the current legal structure), as a government agency, as a working-interest partner with other oil companies introduces distortions and risks.

4) There is no accountability or paper trail for the choice of blocks that Pemex might propose for its farmouts; having the choice of partner/farmee by the chance outcome of a public tender undermines strategic planning.

5) At present, there is an anonymous process by which oil companies nominate blocks for auction, all, some—or none—of which are chosen for public auction for the next (annual) bid round. The

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[11] While it might be attractive to investors for Pemex B to have cash flow from the beginning, the political cost and risk of involving Pemex's oil union in negotiations outweighs any benefit. More fundamentally, in its initial phase Pemex B is an exploration company that seeks partners who will be operators. At a much later phase, it may become itself an operator.

[12] Ronald D. Smith—the Virgil of this section of thi- report—helped us navigate the issues regarding the founding and financing of a private oil company. He is a long-term MEI advisor who has served in his career as the chief financial officer of two publicly traded oil companies and who, until the company was shut down, was a business development consultant with Challenger Minerals, Inc., a unit of Transocean, that specialized in farm-in opportunities.

weakness of this approach was seen in the first auction round held on July 15, 2015, when 8 of 10 blocks received no award.

6) The use of “additional royalty” as a biddable variable introduces distortions in the bidding and misallocates capital that should be invested in work programs.

7) The ad hoc determination of the royalty rate for each block to be auctioned causes unnecessary uncertainty in the economic planning of a contractor-operator that would wish to expand its holdings.

An alternate approach to exploration blocks

An alternate approach would be to remove the block selection process from the Energy Ministry and entrust it to a state-majority-owned exploration company, which, in turn, would seek partners that would serve as operators.[13] The material assets of Pemex-B will consist of blocks with good prospectivity that are selected by its executive team from

1) Pemex-A’s current portfolio, as given to it by the government in Round Zero in 2014.
2) The government’s portfolio, consisting of those blocks that were not awarded to Pemex.
3) Pemex-A’s working interest in joint ventures that may exist at the time (presently, only those with BHP and Chevron).

In addition, a management team will be formed, drawing on the global labor team. Employment opportunities will be non-discriminatory. Special arrangements will need to be worked out for current employees of Pemex-A who apply and who are accepted for employment in Pemex-B.[14]

We itemize the legal and financial steps needed to normalize Pemex’s relationships with other oil companies. For this, the relationship needs to be with a mixed-capital company in which the government holds at least 51% of the shares. The steps listed here are notional, not prescriptive.

Nine steps to a new National Oil Company (with a global vision)

1) Legislation is adopted providing for a mixed-capital company with majority state ownership to qualify as a State Productive Enterprise.

2) A new mixed-capital oil company is created according to the amended law.

3) The Mexican government authorizes US$500 million in seed money, and hires an international executive recruitment to propose candidates for key executive positions.[15] (See Table 1 for examples of key executives.)

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[13] For purposes of discussion, we shall refer to Pemex A (the current company) and Pemex B (the mixed-capital company yet to be founded.)

[14] Such employees are likely to have retirement credits and other benefits, such as vacation credits, that will need to be monetized in ways that are fair to the employee.

[15] The dollar values and percentages given here are meant only for the sake of discussion.

4) A professional management team and board of directors are recruited, with senior positions filled by professionals from Mexico and abroad. [16]

5) The management team identifies non-producing, exploration blocks as found in Pemex's Round Zero portfolio as well as in the portfolio of blocks reserved to the government.

6) Following instructions by the Energy Ministry, Pemex-A transfers selected legacy exploration assets to Pemex B as well as its working interest in joint ventures with private oil companies. The Ministry assigns selected blocks to Pemex B from the government's portfolio.[17]

7) At some point after years of success, an IPO is issued to increase capitalization. The government values its contribution of prospective acreage at a minimum of 51% of the company valuation.

8) The new company (Pemex-B) develops a strategy to seek opportunities in the U.S. Gulf of Mexico and apply for membership in the Center for Offshore Safety as well as in the consortium that supports the Marine Well Containment Company.[18]

9) A legislative carve-out is made for the new company (Pemex-B) to allow it to select its own partners for ventures in Mexico without a public auction conducted by CNH (which, will, nevertheless, have a public oversight role in the prequalification process).[19]

Table 1

Leadership teams of oil companies that were recent IPOs

(as posted online)

	COBALT	KOSMOS
Year of start-up	**2005**	**2003**
Year of IPO	**2009**	**2011**
CHIEF EXECUTIVE OFFICER (CEO)	√	√
CHIFE FINANCIAL OFFICER (CFO)	√	√
OPERATIONS	√	-
EXPLORATION & APPRAISAL	√	√
BUSINESS DEVELOPMENT		√
GENERAL COUNSEL	√	√
GOVERNMENT RELATIONS	√	√
CHIEF GEOSCIENTIST	-	√
DRILLING	-	√
HUMAN RESOURCES	√	-
PRODUCTION & DEVELOPMENT	-	√
ACCOUNTING	-	√

http://www.cobaltintl.com/about-us
http://www.kosmosenergy.com/about-leadership.php

Source: MEI

[16] Employment in the new company would not carry the benefits of union membership or civil service retirement credits. Employees would not be subject to the Federal Employee Accountability Act (LFRSP), which acts as a brake on risk-taking and leadership. Their employment is not subject to presidential dismissal. The chairperson of the board of directors is selected by its members. By-laws determine the number of members that a single owner may have on the board.

[17] The CNH auction regime must continue in parallel, with high-quality blocks also available for public bidding.

[18] www.centerforoffshoresafety.org and www.marinewellcontainment.com

[19] The Energy Ministry will have an advisory role in relation to the selection of properties for joint-equity ventures and the Finance Ministry will have an advisory role in relation to royalties and taxes. Representatives of these ministries will have a voice but not a vote on the board of directors.

How to create Pemex 2.0: the political challenge

There are several sharp turns in the road ahead that leads to a second national oil company in Mexico:

1. Of these, the most important is the management of the narrative. In the first few months of 2008, the administration of Felipe Calderón developed a video on the importance of alliances in deep-water exploration. The video was shown on television and circulated on the Internet. Nevertheless, in the reform legislation of November 2008, not a word was said about deep-water operations.

   The communications strategy of the current administration of Enrique Peña Nieto was weak in relation to the need for an energy reform in either the hydrocarbon or power industries. The government said that it wanted "lower prices for consumers," but instead of lower prices, the government raised prices of motor fuels in January 2017.

   As the Hydrocarbon Law would need amending to allow for a mixed-capital company to be regarded as a State Productive Enterprise, members of Congress will need a powerful narrative that would stand up to the very loud push-back that would be heard from Oil Traditionalists in Mexico.

   The new narrative will have to confront the built-in suspicion that Mexican voters have about the sincerity and honesty of public officials when dealing with the energy sector in addition to the historic distrust of international oil companies.

2. It may be easily be imagined that Pemex's oil union (STPRM by its initials in Spanish) would want any former Pemex employee who would work for the new company to keep his union affiliation, and that the new company would be subject to a collective labor agreement.

3. By 2024, there should be new discoveries and production coming from the blocks that were auctioned in 2015-16; but numbers alone will not win over lawmakers and the public.

4. A comment from the floor at the OTC panel on May 4 reminded the audience that *success by the oil companies and their contractors* in the Mexico's deep-water blocks does not thereby make it a *Mexican* success. One of the rallying cries in the Mexican revolution of 1910 was this: *"Mexico: mother of Foreigners, step-mother of Mexicans."*

OBSERVATIONS

EVEN THOUGH PEMEX E&P had established affiliates with legal domicile in the United States, including one with "GOM" (Gulf of Mexico) in its title, there are reasons to believe that BOEM would not grant it the right to be the operator of a leased block. One objection would likely be that although **Pemex USA (GOM) 1** is an American company, its equity structure traces its way back to 100% ownership by a foreign government.

For the mixed capital company to attract investors in an IPO on the scale of US$15-20 billion, the portfolio of prospective acreage needs to include only prospective acreage.

The take-away lesson for current and prospective operators would seem to be that the surface risk in Mexico that is embedded in the operating, cultural and historical environment is greater than the subsurface risk of finding and producing hydrocarbons.

There is a safety risk for all operators in Pemex's not being a member of the Center for Offshore Safety. Membership requires that Pemex be an operator or investor in assets in federal waters on the American side of the maritime boundary. Until then, and until the oversight regime of ASEA, the hydrocarbon safety agency, gets grounded and staffed, neither Pemex nor any operator in Mexican waters is prepared for an incident of the order of the Macondo blowout and oil spill of 2010.

Said differently, the U.S. side is prepared for the next Macondo, but Mexico's side is not. The Ixtoc-1 oil spill of 1979-80 (the worst in the Gulf up to then) resulted in oil reaching the beaches of Texas; Pemex, however, chose to avoid liability by invoking the U.S. *Foreign Sovereign Immunities Act* of 1977. Another oil spill that reached U.S. waters and beaches could have a disproportionate impact not only in Texas and Louisiana, but also in Washington, D.C.

To avoid confusion and the conflation of ideas and goals, the new company should have a distinct name that does not include "Pemex," for example, **Petróleos Golfo de México, S. A**. (PEGOM).

If a lesson of the energy reform of 2008 is a guide (the government acts timidly after a meanly disputed presidential election), the third energy reform needed for a second national oil company may not take place before 2024.[20]

[20] *El Financiero* (Mexico City), 24 de mayo de 2017. *"¿Podría AMLO revertir la reforma energética?"* The idea was floated during discussions at the energy conference that took place on May 23, and organized by AMEXHI, an oil industry trade association, that it might be possible to protect the precepts of the 2013-14 energy reform by embedding them into a renegotiated NAFTA or other international agreement.

CONCLUSIONS

THE INTERNATIONALL LEGAL FRAMEWORK put in place by **Pemex Exploración y Producción** in 2012 will not achieve the advantages that would be achieved by starting over with a new, mixed-capital company that is majority-owned by the government.

The multiple weaknesses of the current regime will force a change along the lines of the ideas set forth in this report. Mexico's pride in a national oil company should not be limited to one that operates only in Mexican waters, nor one that is not equal, in every respect, to those with which it is in partnership.

In a future OTC panel, an executive from Pemex-B might be able to brag about how in six short years the agreements that his company had closed with diverse oil companies had led to 10 wildcat wells having been drilled the previous year. On the same panel, a commissioner from CNH might observe that the elusive balance had been achieved between cooperation and competition among oil companies, public oversight and environmental stewardship, adding that that Pemex-B had had an alchemical effect that contributed to achieving this balance.

Glossary 1

Pemex subsidiaries, state enterprises and asset transfers

Official terms (sorted by English translation)

	Translation	Lexical Entry
1	**Affiliate**	Empresa filial (Pemex)
2	**Affiliated companies**	Empresas Filiales
3	**Affiliates**	Empresas filiales/2
4	**Assignee**	Cesionario /2
5	**Assignee**	Cesionario
6	**Assignment**	Cesión
7	**Assignor**	Cedente
8	**Carve-out of master lease**	Migración de Asignación
9	**Cesation of rights**	Cesión
10	**Cessation of operations**	Cesión de las Operaciones
11	**Cession of a legacy block**	Cesión de asignación
12	**Cession of rights**	Cesión de derechos
13	**Change of rights, obligations or ownership**	Cesión /2
14	**Contracts with State Ennterprises**	Contratos con Empresas productivas del Estado
15	**Conveyance of block allotment**	Cesión de Asignacion /2
16	**Corporate cession**	Cesión Corporativa
17	**Corporate party or state enterprise**	Persona
18	**Novation of block allotment**	Migración de Asignación
19	**Participating companies**	Empresas Participantes
20	**Pemex subsidiary**	Empresa productiva subsidiaria
21	**Pemex subssidiary**	Empresas productivas subsidiarias de Petróleos Mexicanos

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Pemex subsidiaries, state enterprises and asset transfers

Official terms (sorted by English translation)

	Translation	Lexical Entry
22	**Person (physical or corporate)**	Persona
23	**Productive State Enterprise**	Empresa productiva del Estado
24	**Receiving party [CNH contract]**	Cesionario
25	**Related party**	Filial
26	**State Energy Enterprise**	Empresa productiva del Estado /3
27	**State Energy Enterprise**	Empresa pública de carácter productivo
28	**State enterprise**	Empresa productiva del Estado /4
29	**State Enterprise**	Empresa Productiva
30	**State majority-owned company**	Empresa de participación estatal mayoritaria
31	**State Productive Enterprise**	Empresa Productiva del Estado /2
32	**State-reserved activities**	Areas estratégica
33	**Surrender of Pemex lease**	Renuncia a la Asignación
34	**Working interest**	Interés de Participación:

Pemex subsidiaries, state enterprises and asset transfers

Official terms and definitions

	Lexical entry	Translation	Source	Article
1	**Areas estratégica**	State-reserved activities	Constitución de Mexico (2013)	28
2	**Cedente**	Assignor	Lineamientos ... para celebrar alianzas ... cesión del control (2017)	2
3	**Cesión**	Cesation of rights	Bases de Licitación CNH-R01-L01/2014 (Consortio)	24.1
4	**Cesión**	Assignment	Lineamientos ... para celebrar alianzas ... cesión del control (2017)	2
5	**Cesión /2**	Change of rights, obligations or ownership	BASES DE LA LICITACIÓN CNH-R01-L03/2015	23.1
6	**Cesión Corporativa**	Corporate cession	LINEAMIENTOS ... PARA LA CELEBRACIÓN DE ALIANZAS O ASOCIACIONES ...	2, 7, 16
7	**Cesión de asignación**	Cession of a legacy block	LDH (2014)	8
8	**Cesión de Asignacion /2**	Conveyance of block allotment	Reglamento de la Ley de Hidrocarburos	8
9	**Cesión de derechos**	Cession of rights	LDH (2014)	15
10	**Cesión de las Operaciones**	Cessation of operations	CNH-A1-TRION-C1/2016. Contrato (licencia). Oct. 14, 2016	2
11	**Cesionario**	Receiving party [CNH contract]	LINEAMIENTOS ... PARA LA CELEBRACIÓN DE ALIANZAS O ASOCIACIONES ...	2
12	**Cesionario**	Assignee	Lineamientos ... para celebrar alianzas ... cesión del control (2017)	2
13	**Cesionario /2**	Assignee	CNH-A1-TRION-C1/2016. Contrato (licencia). Oct. 14, 2016	1.1

Found Set: 34 records in search string: PPP 10046

Pemex subsidiaries, state enterprises and asset transfers

	Lexical entry	Translation	Source	Article
14	**Contratos con Empresas productivas del Estado**	Contracts with State Ennterprises	Constitución de Mexico (2013)	27
15	**Empresa de participación estatal mayoritaria**	State majority-owned company	Reglamento - Ley de PEMEX (2014)	T4
16	**Empresa filial (Pemex)**	Affiliate	Ley de Petróleos Mexicanos	60
17	**Empresa Productiva**	State Enterprise	Disposiciones Generales de Contratacion para Pemex (2015)	Definici ones
18	**Empresa productiva del Estado**	Productive State Enterprise	Constitución de Mexico (2013)	25
19	**Empresa Productiva del Estado / 2**	State Productive Enterprise	Constitución de Mexico (2013)	27
20	**Empresa productiva del Estado / 3**	State Energy Enterprise	Ley de Petróleos Mexicanos	2
21	**Empresa productiva del Estado / 4**	State enterprise	LDH (2014)	13
22	**Empresa productiva subsidiaria**	Pemex subsidiary	Ley de Petróleos Mexicanos (2014)	60
23	**Empresa pública de carácter productivo**	State Energy Enterprise	Pacto por Mexico	55
24	**Empresas Filiales**	Affiliated companies	ESTATUTO Orgánico de Pemex Exploración y Producción	4.XIX
25	**Empresas filiales / 2**	Affiliates	Ley de Petróleos Mexicanos	63
26	**Empresas Participantes**	Participating companies	BASES DE LA LICITACIÓN CNH-R01-L03/2015	1.1
27	**Empresas productivas subsidiarias de Petróleos Mexicanos**	Pemex subssidiary	Reglamento - Ley de PEMEX (2014)	T3

Pemex subsidiaries, state enterprises and asset transfers

	Lexical entry	Translation	Source	Article
28	**Filial**	Related party	Bases de Licitación CNH-R01-L01/2014 (Consortio)	1
29	**Interés de Participación:**	Working interest	Lineamientos ... para celebrar alianzas ... cesión del control (2017)	2
30	**Migración de Asignación**	Novation of block allotment	Reglamento de la Ley de Hidrocarburos	23-29
31	**Migración de Asignación**	Carve-out of master lease	LDH (2014)	12, T28
32	**Persona**	Person (physical or corporate)	BASES DE LA LICITACIÓN CNH-R01-L03/2015	1.1
33	**Persona**	Corporate party or state enterprise	Lineamientos ... para celebrar alianzas ... cesión del control (2017)	2
34	**Renuncia a la Asignación**	Surrender of Pemex lease	Reglamento de la Ley de Hidrocarburos	21

Related reports

Year	Topic	File #	Pages	Chart
2017				
May 25, 17	**Bilingual glossary of owners, assets and asset transfers** This glossary includes terms associated with the attributes of the legal figure of State Productive Enterprise, especially in relation to assets and the transfer of assets and management control.	847	10	2
May 17, 17	**Will Mexico drive a deep-water renaissance?** This report draws its title and focus from the panel presentations and discussions on May 4, 2017, at the Offshore Technology Conference (OTC) in Houston. The report draws on other presentations in Houston during the week of May 1. During the panel discussion, speakers emphasized the need to increase drilling activity to an annual average of 20 wildcat wells. For that level of sustained activity, speakers offered suggestions regarding improvement in Mexico's "business platform." Speakers faulted the Finance Ministry for giving greater weight to "additional royalty" as a biddable variable than to work program, noting that the formula resulted in awards to companies that would drill 8 fewer wells than their competitors had offered.	846	12	0
Mar 21, 17	**Houston Roadshow for Mexico's Round Two** On March 9, 2017, a Houston audience was presented with an overview of the upcoming lease auctions in Mexico's Round 2. The principal speaker was Juan Carlos Zepeda, president of the National Hydrocarbon Commission (CNH). Accompanying him were Salvador Ugalde with the Finance Ministry and Oscar Roldán (CNIH). The speakers described improvements to the bidding process, such as allowing a bidder to obtain a certification valid for 5 years for all blocks of that type (such as shallow water). Table 1 compares features of the U.S. and Mexico offshore oil regimes, suggesting that there is just a one-third correspondence. The discussion itemizes concerns voiced offline by prospective contractors.	840	15	2
2003				
Apr 07, 03	**Pemex, S.A.** This report provides an overview of a legislative proposal presented by two PRI congressmen in mid-December 2002 to reorganize Pemex into a "public interest corporation" where 10% of the stock would be open to Mexican investors and retirement fund managers. The proposal has far-reaching implications, as its goals would require new measures of transparency and accountability. The outline and text of the bill, with English headings, is appended.	636	10	1

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