



Mexico's Oil Industry

PRELIMINARY REMARKS

Ever since President Lázaro Cárdenas nationalized the Mexican oil industry in 1938, PEMEX has been deemed as a politically sacrosanct institution. Taking the oil fields back from foreign companies marked a high point in Mexican history. It was one of the few times Mexico's leaders stood up to business interest here and in the United States on behalf of the Mexican society. Consequently, any suggestion of selling off the company to private investors sparks strong protests, especially from left-leaning parties. In the rest of the world, oil is a commodity; in Mexico, it is not only a commodity, but also a symbol of sovereignty and nationalism.

For decades PEMEX has been big cash for the government. PEMEX's profits have provided funds to pay for social programs, operating expenses and governmental salaries, allowing the government to maintain political peace. About 40 percent of the federal budget comes from the oil company.

Some years the government has extracted so much of PEMEX's revenues that it has forced the company to borrow to balance its budget. A questionable oil-workers union, beneficiary of massive contributions from PEMEX, has made matters worse.

Based on the aforementioned, the Federal Government presented, firstly, (i) the 2008 PEMEX diagnostic, and secondly, (ii) a draft bill amending three main instruments for the Mexican oil industry and a draft bill proposing to create the Oil Commission.

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1. 2008 PEMEX DIAGNOSTIC

The 2008 PEMEX Diagnostic was presented by Calderon's Energy Minister and PEMEX's Director General. The scope of the report covers the following aspects:

1. PEMEX productiveness
2. Operational, environmental and industry security challenges
3. Executive capacity
4. Regulatory restrictions
5. Corporate governance

Oil fields current situation

The report affirmed that the lack of investment in exploration and refineries has left Mexico in dire straits. Oil production has been falling since 2005. At the same time, PEMEX has begun to exhaust Mexico's giant offshore Cantarell field, followed by Ku-Maloob-Zaap, Samarina Luna, Marina Suroeste and Bellota Luna reservoirs—which constituted Mexico's 92 percent overall oil production in 2008—. Last year alone, it dropped 5.3 percent to about 3.1 million barrels per day.

Exploration and production

Hydrocarbons reserves have diminished since the mid 80's; this topic represents a major challenge for the Mexican government, as it compromises national energy security.

During 2002 proven reserves total amount was 20.1 billion oil barrels, the equivalent to 13 years' production. Conversely, in 2007 proven reserves total amount was 14.7 billion oil barrels. This is consistent with Mexican oil reservoirs situation. On the one hand main gigantic oil fields have initiated a stage of decline. On the other, new reservoirs do not possess the same production capacity. The strategies proposed in the report to maintain production levels in the short and long terms to improve proven reserves average are the following:

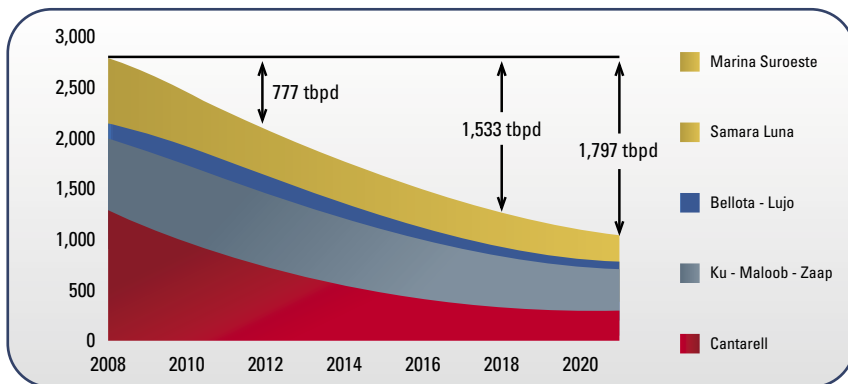
- Discovery of new fields

- Short term new fields production
- Development of proven and probable reserve oil fields
- Enhancement of production, discovery and development costs

Nowadays, Mexico's reservoirs are calculated at 44.48 billion oil barrels. 93 per cent of those reserves are located in the following areas: 41 per cent in the depleting fields, 10 per cent in declining fields and 42 per cent in developing fields. There exist four core exploration areas considered by PEMEX:

- South-east watersheds prospective resources exploration and production
- Abandoned fields exploitation
- Chicontepec development
- Gulf of Mexico deep waters development and exploitation

MAIN ACTIVES OIL ESTIMATED PRODUCTION THOUSAND BARRELS PER DAY 2008-2021



Deep waters production

Deep waters production is the report's main concern. PEMEX has to promptly initiate deep waters development in order to guarantee production for following years.

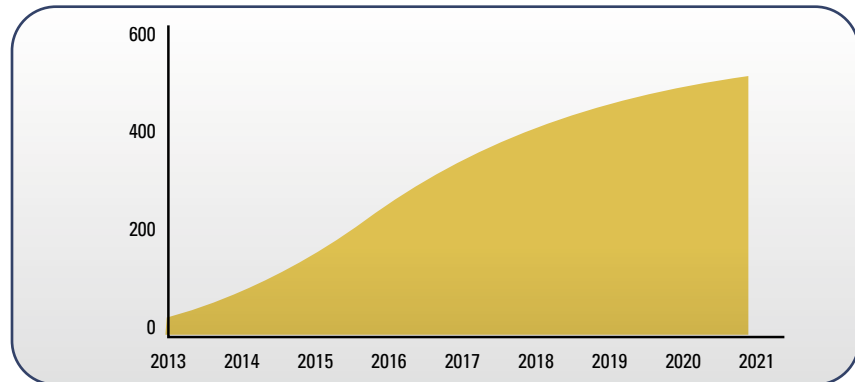
In accordance with 2002-2008 relevant data, there are more than 200 potential exploration sites. In that period, PEMEX had the chance to exploit only 6 new wells (approximately one per year). The report indicated that PEMEX neither possesses the expertise nor the funds to explore risky, deep water oil fields; plus it must enter into partnership with foreign firms, something the Constitution prohibits. The report stresses the current need for PEMEX to enter into joint ventures with other companies to increase its production.

Deep waters characteristics:

- Depth of over 500 meters
- Geological complex variety of structures
- Lack of expertise in risky investment areas
- High cost of discovery and development for exploitation.

In order to maintain current production of 1.3 million oil barrels per day, it is necessary to harmonize deep waters production and current fields' production. In 2021, deep waters production should provide, at least, 500 thousand oil barrels per day.

DEEP WATERS OIL REQUIREMENTS (THOUSAND BARRELS PER DAY)



Transboundary oil and gas reservoirs

Mexico's transboundary oil and gas reservoirs mainly lay across its maritime borders with the United States and Cuba.

Cuba has identified potential resources for more than 13.5 billion oil barrels, situated in the Mexican frontier area. In the northern area, PEMEX has located prospective resources in the frontier area with the United States.

DEEP WATERS AREA 575,000 km²



Pink marks reflect hydrocarbons natural emanations.

Infrastructure

The report highlighted Mexican infrastructure following requirements:

Pipe lines: Mexican pipe lines do not possess technological advantage. Their average age is 24. High energy consumption and clandestine leaks constitute Mexican pipe lines major changes.

Tankers: PEMEX's tankers do not comply with international standards. 12 of them are no longer in operation. Mexican production requires approximately 20 of those vessels.

Land Transportation: There is low efficiency concerning loading and discharging operations. There is no adequate infrastructure and multi-purpose capacity. Long term contracts on new routes are required.

2. FEDERAL GOVERNMENT DRAFT BILL

President Calderón presented to the Congress a draft bill amending three main pieces of legislation for the Mexican oil industry and proposing a new act for the creation of the Oil Commission. The main goals of the draft bill are the following:

- to use by PEMEX of international corporate government practices
- to regulate PEMEX's scheme of operation, to increase its corporate performance
- to strengthen PEMEX's control mechanisms

Nueva Ley Orgánica de PEMEX (PEMEX New Organization Law).

The proposal reflects Calderón's intent to provide PEMEX with international corporate government practices, particularly, giving an extensive operational autonomy to

PEMEX. If this new law is passed, PEMEX's Administrative Council would be modified so as to include a Commissioner. Contracts entered into by PEMEX would have to be paid for prior to the conclusion of the relevant works or services. General public participation would be allowed to finance PEMEX through letter of credits called "bonos ciudadanos". PEMEX directive organ would be allowed to determine the operative and operational structures of the company and decide on the creation of new entities.

Ley Reglamentaria del artículo 27 Constitucional en el Ramo Petrolero (Regulatory Law of Constitutional Article 27).

Under this new law, private investment in the industry would be allowed through a license regime including a mechanism for cooperation in the storage, transportation and management of oil products. The new private investment contracts would not grant property rights on hydrocarbons to investors. Deep waters projects would not allow foreign companies to obtain in return any of the oil found in them. Even though the draft proposes economic incentives for discoveries, profits or production would not be shared.

Ley de la Comisión Reguladora de Energía (Regulatory Energy Commission Law).

This commission would be in charge of fixing first hand sale oil prices, gasoline transportation rates and rates for pipe lines distribution.

Ley de la Comisión del Petróleo (Oil Commission Law).

The main purpose of this commission would be to provide technical assistance to the Ministry Energy. It would

be in charge of finding out the most efficient technology for hydrocarbons exploration and exploitation.

Mexico's oil future debate has focused at the extent the presented draft bill allows private investment and the possibility to privatize the industry. However, the Federal Government's main argument is that although the proposal allows private investment in strategic areas such as management, storage and carriage of hydrocarbons, PEMEX maintains its property rights over oil. In addition, Mexico's plan would allow PEMEX to enter into service contracts with foreign oil companies without privatizing the industry and without having to amend the Constitution. It must be noted that the Mexican Constitution prohibits the State oil-monopoly to form risk-sharing joint ventures with other oil-companies.

Some of the most important criticisms to the draft bill is that PEMEX would be left outside the oil production chain. PEMEX would be solely in charge of oil sales, imports and exports.

As President Calderón's party does not have a majority in the Congress, he would have to persuade members of the former governing party, the Institutional Revolutionary Party, (PRI) in order for the draft bill to be passed.

For more information, contact:
David Enriquez –
denriquez@goodrichriquelme.com

or Carlos Moran –
cmoran@goodrichriquelme.com

MEXICO
(main office)

Paseo de la Reforma 265
06500 Mexico City, MEXICO
Tel: + (5255) 5533 0040
Fax: + (5255) 5525 1227
www.goodrichriquelme.com
mailcentral@goodrichriquelme.com

EUROPEAN OFFICE

8/10, Rue Ventadour
75001 Paris, FRANCE
Tel: + (331) 4260 2700
Fax: + (331) 4260 2713
www.goodrichriquelme.com
graparis@goodrichriquelme.com