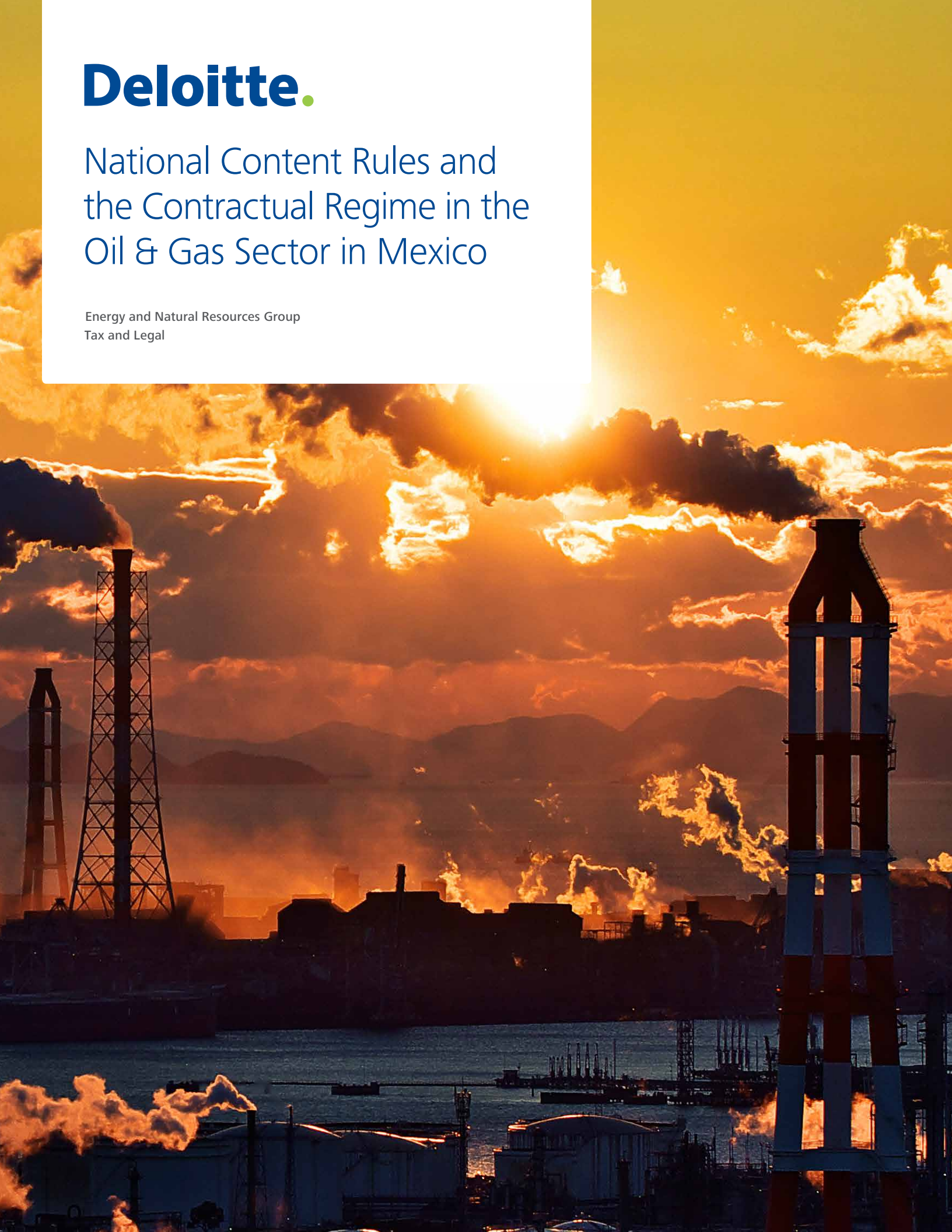




National Content Rules and the Contractual Regime in the Oil & Gas Sector in Mexico

Energy and Natural Resources Group
Tax and Legal



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Among the premises of the Energy Reform derived from the changes in the Mexican Constitution made on December 2013 is the protection of the domestic market. So-called secondary legislation on energy matters establishes percentages of local content, percentages which are also specified in the bidding process for the award of production sharing contracts for exploration and production of hydrocarbons in shallow waters (Round One), by way of the Contract for exploration and extraction of hydrocarbons in the form of production sharing (the Model Contract).

In addition to the methodology for measuring local content established by the Ministry of Economy and published last November 13, 2014 (which can be divided into origin of goods and services, labor, training, infrastructure and technology transfer), the Model Contract for Round One sets contractual obligations applicable to contractors which we mention below.

The local content myth

In practice, potential participants in tenders for contracts for exploration and extraction of hydrocarbons in both phases --the design and the implementation of projects-- should develop work programs as requested by the Government, and incorporate the existing methodology applied by experienced specialists on determining content in goods, services, local hiring, training, technology transfer and investment in the improvement of national infrastructure.

For new participants in these contracts, national content goes beyond the mere nationality of suppliers, requiring, for example, detailed product integration, given that it must meet production criteria and minimum values of materials. This also implies that participants must ensure (proactively and continuously) that their suppliers in the oil industry meet the requirements that are imposed upon them, for example by validating the origin of the products.

The Contract Model establishes a minimum percentage of domestic content in stages (13% in the period of exploration, 25% in the first year of the development period and up to 35% in 2025) in accordance with Methodology established.

Services

A preference for procurement of national origin (including for hiring technical and managerial level, people of Mexican nationality) also becomes tangible when there is equality of circumstances and characteristics in price, quality and delivery times.

Transfer of technology

The Contractor shall comply with the technology transfer programs approved by the National Hydrocarbons Commission both on exploration plans and on development plans; which shall include the adoption, innovation, assimilation, research and technological development in scientific and technological research in coordination with institutions of higher education.

Consequences of failure to comply and preventive measures

In order to ensure adherence to the established criteria, the Model Contract requires drafting plans for compliance with local content. Furthermore, failure to comply shall have significant impacts such as penalties to be paid by the contractor going from 15% to 100% of the amount of the commitment.

The application of the methodology, expertise, insight and management of these issue carried out with the authorities, may impact how projects are delineated as well as financial repercussions.





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