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Sharing the Crown Jewel: Mexico to liberalize its oil industry

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When Hernan Cortez first laid eyes on the riches of the Aztec Empire, he thought he had found the land of "El Dorado." While the gold riches were enough to finance the European Renaissance – turning European pirates into wealthy knights – the real crown jewel of the Aztec Empire is today not measurable in bullion, but in billions of barrels of black gold.

In Mexico, a deep resentment toward colonialism culminated in 1910 in the first socialist revolution of the 20th century.

Public sentiment caused a very fervent form of resource nationalism to take hold. Petróleos Mexicanos, or Pemex, eventually came into being in 1938 when socialist president Lázaro Cárdenas nationalized the industry, barring the crown jewel from foreign prying.

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Fast forward 75 years. President Enrique Peña Nieto, bowing to pressure to improve the finances of this central pillar of the Mexican economy, presented his energy reform plan last year. It appears very likely that the plan will pass through Congress, although its implementation will be phased in gradually over time. The reform does not go so far as to provide for outright ownership of the reserves by foreign corporations. It is instead similar to profit-sharing agreements common in many oil-producing jurisdictions around the world.

The federal government is very wary about inciting any populist counter-movements, especially those that rally behind the defeated former presidential candidate for the left-wing Party of the Democratic Revolution (PRD), Andres Lopez Obrador, who staunchly opposes the reform. In an ironic turn of events, the son of President Cardenas, Cuauhtémoc Cárdenas, the current leader of the PRD, has softened his anti-reform rhetoric. Rumours have it that Cárdenas is even talking about favoring the transformation of Pemex into a public corporate entity. Even the most radical left-wing members of Congress understand that Mexico cannot afford further production losses at Pemex, which has dropped 15 to 20 per cent from its peak. With 30 per cent of government revenues depending on petroleum revenues, the stakes are high.

The lion's share of opportunity is onshore and in the shallow littoral waters of the Gulf. A number of Canadian oilfield service companies have already made their mark in "the land of the shaking earth." The industry liberalization is creating considerable opportunities for small- and medium-sized exploration and production players with past (or planned) international experience combined with expertise in unconventional resource development in shale gas and tight oil.

In comparison to other oil-producing jurisdictions worldwide – many of them remote and politically unstable – Canadian companies see the advantages afforded by NAFTA partner Mexico. At the same time, Pemex cannot claim for itself an entirely lilywhite reputation so foreign investors must go into profit sharing arrangements with their eyes open.

While the current legal framework disallows reserve ownership and concessions, in 2006 Pemex introduced general service contracts that permit foreign oilfield service companies to carry out everything from exploration and drilling to well completion. The success of this approach was limited, but it has nevertheless been regarded as an important step towards really debarring access to the country's "crown jewel" for international operational knowhow and capital. President Nieto's reforms hold the promise of going even further. Mexico's official estimate puts its deep water and shale oil reserves at 87 billion barrels. It has up to 87 billion barrels of oil and gas in deep water and in shale, 45 to 70 per cent being accessible with Canadian technology.

The reform of the Mexican constitution and the ensuing liberalization of the petroleum industry may not go as far as foreign operators had been hoping for. Companies still remain limited in their ability to transfer oil reserves onto balance sheets. But for any service company willing to take the risk, potential payoffs could be enormous.

Ed Rodriguez is the president of PrivateBanx Wealth Management and a member of the Canada-Mexico Chamber of Business.
