

International Comparative Legal Guides



Oil & Gas Regulation 2020

A practical cross-border insight into oil and gas regulation work

15th Edition

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1 Overview of Natural Gas Sector

1.1 A brief outline of your jurisdiction's natural gas sector, including a general description of: natural gas reserves; natural gas production including the extent to which production is associated or non-associated natural gas; import and export of natural gas, including liquefied natural gas (LNG) liquefaction and export facilities, and/or receiving and re-gasification facilities ("LNG facilities"); natural gas pipeline transportation and distribution/transmission network; natural gas storage; and commodity sales and trading.

Mexico's current position in the natural gas ("NG") sector is an invitation for long-term investments from public and private stakeholders, either through direct participation in upstream tenders for exploration and production ("E&P") contracts, to favour the increase of domestic production, to achieve the liquidity of the new trading market, or to continue expanding the NG pipeline system.

There was a slight increase in 2019 compared to NG reserves in 2018:

2018 (million cubic feet)	2019 (million cubic feet)
1P: 10,022.42	1P: 9,654.35
2P: 19,337.87	2P: 20,824.34
3P: 30,020.35	3P: 32,367.57

Local demand for natural gas has increased 32% in the last 12 years. During 2019, the average demand was around 8,000 million cubic feet per day ("mmcf/d"), while domestic production of dry gas reached 2,587 mmcf/d. According to the National Centre of Natural Gas Control ("CENAGAS"), Mexico's independent system operator of the NG pipeline system, projected national demand will reach up to 14,500 mmcf/d by 2024.

In September 2019, domestic production reached a volume of 5,016.62 mmcf/d, 2% higher compared to September 2018. Associated gas production in September 2019 was 3,998.582 mmcf/d. The volume of non-associated gas was 1,018.047 mmcf/d (<http://sie.energia.gob.mx/bdiController.do?action=cuadro&subAction=applyOptions>).

Imports have increased around 15% in the last decade. During 2018, imports accounted for 88% of national consumption of natural gas; 90% of imports coming from the United States. Historical domestic demand for NG has grown in the last 10 years at an average annual rate of 3.0%. The power sector is the largest fuel consumer, concentrating around 54% of total demand. In 2019, the value of imports broke records derived from growing demand in Mexico, in addition to attractive

prices in the U.S., which are lower in relation to the costs of local extraction. The increase resulted from the continued decline of local production and the operation of additional kilometres of gas pipelines. Currently, 24 companies other than Petróleos Mexicanos ("Pemex"), the State-Owned Productive Enterprise ("SPE"), have access to 36% of the capacity of the National Integrated Transportation and Storage System ("SISTRANGAS").

Mexico's coastline (of more than 11,000 km and with more flexible regulations on the Pacific Coast compared to other jurisdictions such as the U.S.) and the regions of Baja California, Sonora, Sinaloa and Nayarit, are attractive LNG export points to Asian markets. For instance, Sempra is in the process of increasing the LNG capabilities of its Costa Azul existing facility in Ensenada, Mexico, with the off-take of the French company Total. The project will have a total export capacity of 2.5 metric tons *per annum* ("mtpa") for phase 1 and 12 mtpa for phase 2. Mexico Pacific Limited plans to build a 2-4 mtpa LNG facility in Puerto Libertad, Sonora. The LNG projects will rely on the granting of an export permit by the Ministry of Energy ("SENER"), taking into consideration sufficient supply to cover local demand.

The policy of increasing the country's gas pipeline network by 67% as of 2012 is based on the imports of gas by private companies and the growing participation of the Federal Electricity Commission ("CFE") in the NG/LNG market. Currently, Mexico has 17,210 km of operating pipelines, plus an additional 1,679 km under construction.

These new market conditions allowed the adoption of NAESB-type agreements, which allow for back-to-back trading and import transactions with traders in the U.S., which allows Mexico to move towards a liquid market. However, an interconnected NAESB system where all players can be purchasers and/or sellers at the same time is still pending.

1.2 To what extent are your jurisdiction's energy requirements met using natural gas (including LNG)?

Nearly 80% of electricity generated in Mexico comes from fossil fuels or carbon. Mexico is transitioning towards cleaner and renewable energies in the generation of electric power. The general trend in thermal generation is a reduction in petroleum-based fuels and an increase in NG.

It is expected for NG to become the predominant fuel, concentrating 60.3% of the total consumption for power generation by 2031. By 2030, it is estimated that generation will reach 505 terawatt hours.

In this regard, the CFE's generation infrastructure expansion programme includes five combined cycle projects, which are

planned to be installed in the states of San Luis Potosí, Sonora, Baja California Sur, Campeche and Guanajuato.

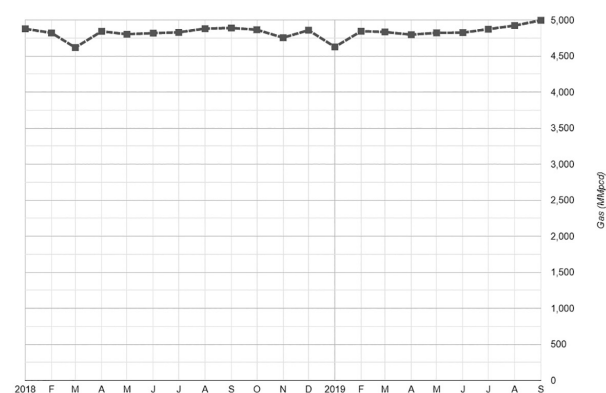
1.3 To what extent are your jurisdiction's natural gas requirements met through domestic natural gas production?

Mexico's production of NG has steadily decreased since 2009, when it reached its maximum level of extraction, estimated at 7,030 mmcf/d, to 4,995.35 mmcf/d by September 2019, which represents a fall of 29%.

The increase in constant demand had to be met through imports. In 1998, Mexico bought 146 mmcf/d in foreign markets. As of June 2018, it imports 5,106 mmcf/d from the U.S.; an increase of 3,397%.

Domestic production during 2018 and 2019 has been below 5,000 mmcf/d.

Gas production in Mexico

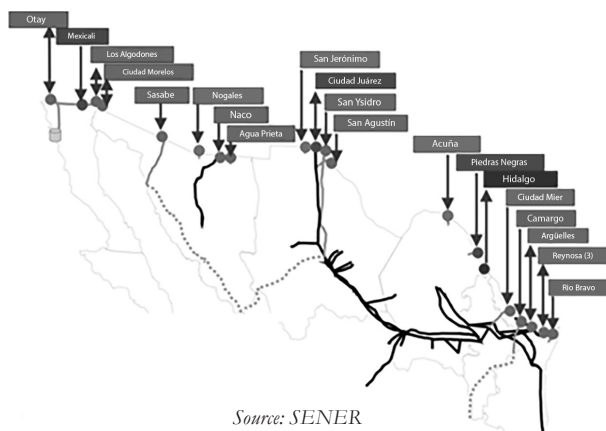


Source: CNH

1.4 To what extent is your jurisdiction's natural gas production exported (pipeline or LNG)?

Mexico is an important consumer of NG produced in the U.S. It is estimated that in 2031, demand for dry NG will reach a volume of 9,659.9 mmcf/d; imports are projected to reach 4,613.6 mmcf/d, while exports will be zero.

Rising demand and higher import volumes from the U.S. justified the construction of numerous import gas pipelines connecting the U.S. and Mexico. The current network will be boosted by the new submarine pipeline that connects Texas with Veracruz, adding 2,600 mmcf/d of capacity. This submarine pipeline started operations on September 17, 2019.



Source: SENER

2 Overview of Oil Sector

2.1 Please provide a brief outline of your jurisdiction's oil sector.

Oil and gas activities are governed by federal law. The primary legal framework includes the Constitution, Hydrocarbons Law ("HL"), Hydrocarbons Revenue Law ("HRL"), Law of the Regulatory Coordinated Bodies in Energy Matters (governs the organisational framework of the National Hydrocarbons Commission ("CNH") and the Energy Regulatory Commission ("CRE") and Law of the National Agency for Industrial Safety and Environmental Protection of the Hydrocarbons Sector, among other federal regulations, rules, general administrative provisions, and guidelines.

The current legal framework is enforced by:

- SENER—responsible for the national energy policy.
- The Ministry of Finance and Public Credit ("SHCP") – has the authority to verify and regulate oil revenues of the state and to determine the economic conditions of E&P Contracts.
- CNH – responsible for the bidding and award of E&P Contracts, as well as the regulation of hydrocarbon E&P activities.
- CRE – responsible for issuing technical and economic regulations, granting and managing permits, verifying compliance, imposing sanctions on midstream and downstream activities and the entire power sector chain.
- The Agency of Security, Energy and Environment ("ASEA") – responsible for regulating and supervising industrial and operational safety, and environmental protection in the hydrocarbons sector.

The constitutional amendments of late 2013 established full guiding principles for government authorities in the sector:

1. Hydrocarbons in the subsoil belong to the Mexican Nation.
2. Free competition between SPEs and private companies to benefit consumers.
3. Strengthening of SPEs and regulatory agencies.
4. Transparency and accountability.
5. Environmental protection and promotion of clean energies.

CNH and CRE have managerial, technical and operational autonomy. These commissions were created as part of a wave of institutions with an autonomous mandate in the 1990s. The logic behind the new institutional arrangement was to consolidate public agencies of a technical nature, with highly specialised personnel, whose decisions are impartial and isolated from any political influence or special interests.

Other relevant regulations and policies are:

- a. Open and non-discriminatory access to midstream facilities for NG and petroleum products, which means that (i) spare capacity is accessible to any potential user, and (ii) terminal and pipeline companies should not give discriminatory treatment between users, who may request/demand that the company offers them the special conditions granted to other users under equivalent circumstances.
- b. Public Policy on Minimum Stocks of Refined Products, and Public Policy on Minimum Stock of NG, which intend to strengthen energy security through an obligation to maintain minimum inventories, to reduce risk of lack of supply.
- c. Asymmetric regulations applicable to Pemex, to control its dominant market power upon the opening of the energy sectors to private investment.
- d. Quality specifications of fuels throughout the value chain, to protect the environment and health, promote equivalent conditions for competition, and protect end consumers.
- e. Regulation of vertically integrated entities and restriction of cross-ownership.

2.2 To what extent are your jurisdiction's energy requirements met using oil?

According to SENER, electricity production is dominated by fossil fuels, which account for 78% of electricity in Mexico.

Combined-cycle gas power plants already represent the biggest share and are growing fast. NG is substituting other energy sources like fuel oil and diesel. A steady decline in oil production since the 1980s is slowly decoupling the Mexican economy from oil exports. By 1982 these represented 18% of the country's GDP, while in recent years this percentage has decreased to 4%. A marked increase in imports is also taking place, mainly in refined products and dry gas from the U.S.

2.3 To what extent are your jurisdiction's oil requirements met through domestic oil production?

There has been a downward trend in oil production for the past 10 years, to an average annual growth rate of -3.8%. Data published by SENER shows that in January 2019, production averaged 1.61 million barrels per day ("mmbd"), its lowest level since 1980. Nearly 80% of crude oil is produced offshore. The decrease in local production has translated into reduced refining volumes and increase of imports. In September 2019, Mexico reached its highest level of imports of motor-fuels, accounting for 75% of local consumption.

2.4 To what extent is your jurisdiction's oil production exported?

Nearly 56% of Mexico's crude oil production is distributed to export terminals. During 2018, Pemex exports numbered 1.184 mmbd. Most exports were destined for the U.S. However, Mexico is the biggest importer of U.S. refined products.

3 Development of Oil and Natural Gas

3.1 Outline broadly the legal/statutory and organisational framework for the exploration and production ("development") of oil and natural gas reserves including: principal legislation; in whom the State's mineral rights to oil and natural gas are vested; Government authority or authorities responsible for the regulation of oil and natural gas development; and current major initiatives or policies of the Government (if any) in relation to oil and natural gas development.

The national energy model allows the participation of SPEs (i.e., Pemex) and private companies in equal circumstances.

Hydrocarbons in the subsol belong to the State. Development rights are granted by CNH, in the form of entitlements to SPEs or through international bidding rounds for the award of production sharing, profit sharing, licence contracts, or service contracts.

The primary regulator and counterparty of oil producers is CNH. Other governmental bodies actively participate in E&P, including SHCP, ASEA, the Ministry of Economy, in connection with the percentage of local content requirements, and the Mexican Petroleum Fund, whose purpose is to receive, manage and distribute the income derived from E&P activities.

Important regulatory considerations are:

- The state profits from private investment in oil and gas come from the payment of royalties, taxes, bonuses, and other fees.

- Farm-outs have allowed Pemex to develop strategic alliances with IOCs.
- There are local-content requirements in the regulations that establish that E&P activities must reach an average of 35% of local content in the entitlements and contracts by the year 2025.
- The current legal framework provides high care for environmental protection and social impact.
- CNH has exercised its autonomy, among others in the form of sanctions to Pemex for breaching gas flaring limitations.
- A bill prohibiting the use of fracking is being analysed by Mexico's senate.

Mexico's recently elected government took office in December 2018, and is reviewing the Energy Reform as a whole; among its first actions was to suspend E&P upstream tenders indefinitely. However, operators have been allowed to continue to perform their E&P activities under previously awarded E&P contracts.

3.2 How are the State's mineral rights to develop oil and natural gas reserves transferred to investors or companies ("participants") (e.g. licence, concession, service contract, contractual rights under Production Sharing Agreement?) and what is the legal status of those rights or interests under domestic law?

Mexico does not grant concessions to exploit oil and gas rights by private investors, only different types of agreements.

To date, 111 E&P Contracts have been signed by the Mexican government with IOCs and local petroleum companies.

The main difference between a concession-based *vs.* contractually based oil development framework is that the concession is granted to provide a public service or exploit property of public domain, meaning that the concession creates a right in favour of the concessionaire, while the contract-based model allows the state to maintain the original rights over the hydrocarbons and their development, for which it contracts the E&P activities with an SPE or private entity.

3.3 If different authorisations are issued in respect of different stages of development (e.g., exploration appraisal or production arrangements), please specify those authorisations and briefly summarise the most important (standard) terms (such as term/duration, scope of rights, expenditure obligations).

Mexico's oil development is highly regulated from different angles: energy and environmental/social matters.

Once an E&P Contract is executed, the operator has the right and obligation to perform the E&P activities, meaning that it will not require a special permit or licence by CNH to do so, but will rather have to obtain several approvals from CNH throughout the term of the contract, including but not limited to:

- Exploration and appraisal plans.
- Authorisation in connection with a change of control in the field operator.
- Suspending E&P activities.
- Additional terms.
- Drilling.
- Gas flaring.

Other considerations related to the development of hydrocarbons are:

- Authorisations for surface exploration studies, carried out in order to locate the possible existence of hydrocarbons in the subsol.

- Prior to the granting of an entitlement or the publication of a call for a public bid, SENER, in coordination with the Ministry of the Interior (“SEGOB”), carries out a study of social impact with respect to the subject area of the entitlement or the contract.
- In order to consider the interests and rights of the communities and indigenous peoples, SENER must carry out the necessary informed consultation procedures, in coordination with SEGOB and the corresponding agencies.

Given the high number of regulations, there is an area of opportunity to cut bureaucratic roadblocks. CNH has made efforts to achieve a leaner and more efficient regulatory process and intends to continue working on expediting processes to approve exploratory and appraisal plans.

Performance of midstream and downstream activities require a permit granted by CRE or SENER, as follows:

Crude treatment	Oil conditioning that includes industrial processes carried out outside a contract area or an entitlement area and prior to refining.
Gas processing	Includes physical and chemical processes to which NG is subjected, as well as associated condensates, to obtain refined products and petrochemicals, capable of being marketed, or used as an input for industrial transformation.
Refining	The set of physical and chemical processes to which the crude oil is subjected to convert it into refined products and petrochemicals.
Storage	Deposit and safeguard of hydrocarbons, refined products and petrochemicals in deposits and confined facilities.
Transportation	The activity of receiving, delivering and, where appropriate, driving hydrocarbons, refined products and petrochemicals, from one place to another by pipelines or other means; it does not entail the transfer of title to or marketing of said products. It excludes the gathering of hydrocarbons within the contract/entitlement area.
Distribution	Logistical activity that includes the transfer and storage of NG or refined products, from a specific location to one or several assigned destinations, for its retail sale or final consumption.
Marketing	The activity of offering users or end-users: <ul style="list-style-type: none"> i. the sale of hydrocarbons, refined products or petrochemicals; ii. management or contracting transportation, storage or distribution services; and/or iii. the provision or intermediation services. Marketing permits do not entail the ownership of the infrastructure or the provision of services.
Retail sale	Sales performed directly to the consumer of NG or petroleum products, among other fuels, in facilities with a specific or multimodal purpose.

3.4 To what extent, if any, does the State have an ownership interest, or seek to participate, in the development of oil and natural gas reserves (whether as a matter of law or policy)?

The Mexican State is the owner of the hydrocarbons in the subsoil. Once E&P activities are performed by state or private participants, the state receives the consideration provided in the HRL.

Without exception, private participants may neither acquire title to, nor grant security interests in hydrocarbons in the subsoil until such applicable consideration (in cash or in-kind) is paid to the State.

Upon the energy reform, the national oil company Pemex retained certain E&P rights through the entitlements granted to it in Round Zero: 34,800 million barrels of oil equivalent in prospective resources, which represents 31% of the country’s total; and 20,589 million barrels of oil equivalent in 2P reserves, that is, 83% of total 2P reserves.

Regarding the activities that will be carried out by Pemex, the current administration has expressed the intention of executing service contracts between Pemex and private companies to carry out extraction activities (e.g., drilling), mainly in shallow waters of the Gulf of Mexico.

3.5 How does the State derive value from oil and natural gas development (e.g. royalty, share of production, taxes)?

In accordance with the HRL, the State receives tax contributions from entitlements to SPEs. In connection with E&P Contracts, in general, the State receives a royalty and a fee for the exploratory phase. In licence contracts it also collects an additional amount of the value of the hydrocarbons and, if applicable, a signing bonus offered by the operator in the bidding process. In production sharing and profit-sharing contracts, the State receives a percentage of the profits of the project, either in kind or in cash, respectively.

The payment of the considerations does not exempt the operators from complying with the tax obligations established in the fiscal laws and regulations.

3.6 Are there any restrictions on the export of production?

Generally speaking, there are no restrictions to the export of production. However, for the export of NG and refined products, SENER, as a policy, grants export permits trying to not affect the domestic balance and supply.

3.7 Are there any currency exchange restrictions, or restrictions on the transfer of funds derived from production out of the jurisdiction?

There are no currency exchange or warranty or currency transfer restrictions in Mexico.

3.8 What restrictions (if any) apply to the transfer or disposal of oil and natural gas development rights or interests?

The operator must obtain CNH’s authorisation prior to any sale, assignment, transfer or disposal of all or part of its rights/obligations under the E&P Contract and to transfer the corporate control or operational management.

Notwithstanding the foregoing, consortium members acting as operators must notify CNH of any change in its capital structure that does not result in a change of control of the operator. Such provisions do not distinguish between direct or indirect changes in the capital structure of any of the contractors, so any indirect changes must also be notified.

E&P Contracts generally allow the consortium members to change the operator with prior authorisation from CNH.

CNH recently approved two banking institutions to be beneficiaries of encumbrances constituted on the participation interests of E&P contracts. The first case involved the Egyptian company Cheiron, who used its participation in a Farm-out Contract as a guarantee to obtain financing from Natixis, while the second case was the Mexican company DS Servicios Petroleros and D&S Petroleum which were granted a lien of their participation interest in the E&P contract as a guarantee in favour of Banco Mercantil del Norte (Banorte).

3.9 Are participants obliged to provide any security or guarantees in relation to oil and natural gas development?

Participants of bidding processes must present a bid guarantee to be able to submit economic proposals for the award of contract areas. The bid guarantee is kept by CNH until the awarded party signs the E&P Contract. If the winner fails to sign on the set date, CNH will enforce the bid guarantee.

In addition, E&P Contracts provide for the following guarantees:

- Performance guarantee.
- Corporate guarantee of the ultimate parent or duly-capitalised affiliate guarantee to secure compliance of all the unpaid obligations of the contractor.
- If the awarded party desires to execute the E&P Contract through a special purpose vehicle, the entity that participated in the bidding process, usually the IOC, will have to sign the E&P Contract as joint obligor of the field operator (SPV).

3.10 Can rights to develop oil and natural gas reserves granted to a participant be pledged for security, or booked for accounting purposes under domestic law?

According to the HL, field operators will have the right to report, for accounting and financial purposes, the entitlement or the E&P Contract, as well as the expected benefits thereof.

3.11 In addition to those rights/authorisations required to explore for and produce oil and natural gas, what other principal Government authorisations are required to develop oil and natural gas reserves (e.g. environmental, occupational health and safety) and from whom are these authorisations to be obtained?

Other authorisations related to oil and gas production are mentioned in question 3.3 and, in addition, operators must consider the following:

- Preparation of the Risk Analysis for the hydrocarbons sector.
- Authorisation from environmental authorities to change the use of land.
- Authorisation of the Management System for Industrial, Operational and Environmental Safety (“SASISOPA”), which is an integral set of documented elements for prevention, control and improvement in matters of industrial and operational safety and environmental protection.

- Preparation of the environmental baseline to determine pre-existing environmental damage and liabilities for which the contractor will not be liable.

Transformation activities are subject to obtaining the relevant permits, such as NG processing, oil treatment, compression, decompression, liquefaction, and regasification.

3.12 Is there any legislation or framework relating to the abandonment or decommissioning of physical structures used in oil and natural gas development? If so, what are the principal features/requirements of the legislation?

Abandonment includes all activities for the removal and dismantling of materials, including permanent plugging and technical closure of wells, removal and dismantling of all plants, platforms, facilities, machinery and equipment used during the E&P activities, as well as environmental damage restoration in the contract area affected by the contractor, in terms of the E&P Contract, industry best practices, and the field operator’s SASISOPA.

For the purpose of carrying out abandonment activities, the field operator shall form an investment trust known as an “abandonment trust” at a reputable and creditworthy Mexican banking institution. The contractor may not use the funds deposited in the abandonment trust for any purpose other than conducting the abandonment activities, and shall not be entitled to pledge, assign or otherwise dispose of the resources in the abandonment trust.

3.13 Is there any legislation or framework relating to gas storage? If so, what are the principal features/requirements of the legislation?

Storage of NG requires a permit granted by CRE, subject to “open and non-discriminatory access”. Please see question 2.1.

Storage assets should operate in accordance with (i) General Terms and Conditions (“GTCs”), which should be drafted following certain guidelines provided by CRE in its regulations, and (ii) the SASISOPA, for purposes of industrial safety and environmental protection.

3.14 Are there any laws or regulations that deal specifically with the exploration and production of unconventional oil and gas resources? If so, what are their key features?

ASEA issued the General Administrative Provisions (“DACGs”) that establish the guidelines on industrial safety, operational safety and environmental protection to perform the activities of E&P of hydrocarbons in unconventional deposits onshore.

According to such DACGs, risks should be minimised to a level that is as low as reasonably feasible. The mechanisms related to the reduction of risks and environmental impacts, and response to emergencies must follow the following order of priority:

- a) Physical integrity of the people.
- b) Protection of the environment.
- c) Protection of the facilities.

General activities covered by this regulation are:

- Industrial safety and environmental protection.
- Design, construction, pre-commencement and maintenance.
- Drilling and management of fluids.
- Finishing of the wells.

- Return fluid management.
- Gathering and mobilisation of hydrocarbons.
- Production tests.
- Decommissioning and abandonment.

4 Import / Export of Natural Gas (including LNG)

4.1 Outline any regulatory requirements, or specific terms, limitations or rules applying in respect of cross-border sales or deliveries of natural gas (including LNG).

Import and export are subject to a permit granted by SENER, in addition to the registrations related to foreign-trade before SHCP.

5 Import / Export of Oil

5.1 Outline any regulatory requirements, or specific terms, limitations or rules applying in respect of cross-border sales or deliveries of oil and oil products.

Import and export activities are subject to a permit granted by SENER. Marketing and sale are subject to different permits, depending on the scope of the activity. Please see question 3.3.

6 Transportation

6.1 Outline broadly the ownership, organisational and regulatory framework in relation to transportation pipelines and associated infrastructure (such as natural gas processing and storage facilities).

“Transportation” within the contract area to the processing facility usually falls under the “gathering” activity per Mexican regulations. The distinction between “transportation” *vs.* “gathering” has heavy implications under statutory provisions, since pipeline “transportation” is subject to open access principles whereas the “gathering” pipelines are not.

The model E&P Contract used by CNH so far provides a prohibition to the field operator to lease the necessary gathering facilities, in order to ensure the continuity of the E&P activities.

Most gathering facilities are currently owned by Pemex who can provide services to private field operators or purchase the hydrocarbons produced by the field operator, setting transfer of custody and ownership before the gathering facility.

CNH may issue regulations for gathering facilities shared by two or more field operators.

6.2 What governmental authorisations (including any applicable environmental authorisations) are required to construct and operate oil and natural gas transportation pipelines and associated infrastructure?

Gathering facilities are part of the “Petroleum Activities” under the “Extraction” or “Production” phase, as these terms are defined in the model E&P Contract. Therefore, the development of such infrastructure must be approved within the appraisal plan by the CNH. In production sharing and revenue sharing contracts, gathering facilities are subject to cost recovery rules. The gathering activity should be included by field operators in the preparation of their SASISOPA.

6.3 In general, how does an entity obtain the necessary land (or other) rights to construct oil and natural gas transportation pipelines or associated infrastructure? Do Government authorities have any powers of compulsory acquisition to facilitate land access?

Hydrocarbons development is a strategic area of federal jurisdiction, meaning that the development of E&P activities has preference over other potential use of the land (i.e., fishing, agriculture). The applicable law provides procedures for securing land rights, which shall be obtained by the field operator. Additionally, SENER issued the guidelines that establish parameters to determine the consideration for commercial extraction that the entitlement holder or contractor will deliver to the owners when their projects reach the commercial production of hydrocarbons.

According to the guidelines and the different modalities of use, affectation or, where appropriate, acquisition of the lands agreed between the entitlement holder or contractors and the owners of the land, land owners will be entitled to a consideration, as applicable: the payment of damages to goods or rights other than the land, as well as the forecast of the damages that could be suffered due to the project to be developed; the rent for the occupation, easement or use of the land; and, in the case of projects that achieve the commercial extraction of hydrocarbons, a percentage of the income corresponding to the entitlement holder or contractor.

6.4 How is access to oil and natural gas transportation pipelines and associated infrastructure organised?

As explained above, gathering facilities are part of “Petroleum Activities” under the “Extraction” phase. CNH has not issued any other type of regulation. E&P contracts provide the obligation to allow common use of gathering infrastructure, such as pipelines. However, pipelines used in the “transportation” of oil and NG, as such term is defined in the HL, are subject to a transportation permit from CRE and open-access and non-discriminatory obligations.

6.5 To what degree are oil and natural gas transportation pipelines integrated or interconnected, and how is co-operation between different transportation systems established and regulated?

Pemex still maintains most of the gathering facilities, which makes their participation almost necessary in E&P production to a certain extent. As a result of the energy reform and the opening of the markets, new IOCs have initiated operations of their awarded E&P Contracts, which means that we anticipate an increase in the number and capacity of gathering facilities.

In relation to transportation systems, the regulation allows such systems to be integrated for tariff purposes. To date, Mexico only has one integrated system: the Integrated National Transportation and Storage System (SISTRANGAS), which is managed by CENAGAS. The SISTRANGAS is made up of private pipelines and pipelines owned by CENAGAS, all under the same tariff and capacity allocation rules.

The new administration is analysing whether private pipelines shall be integrated to the SISTRANGAS to allow for a national management of capacity by CENAGAS, with the intention to benefit uniformity, continuity and efficiency.

6.6 Outline any third-party access regime/rights in respect of oil and natural gas transportation and associated infrastructure. For example, can the regulator or a new customer wishing to transport oil or natural gas compel or require the operator/owner of an oil or natural gas transportation pipeline or associated infrastructure to grant capacity or expand its facilities in order to accommodate the new customer? If so, how are the costs (including costs of interconnection, capacity reservation or facility expansions) allocated?

Gathering facilities are not subject to open-access principles, as opposed to pipeline transportation (beyond the frontier of the contract area) or storage. Pipeline transportation services are subject to regulated tariffs, proposed by the operators and approved by CRE.

6.7 Are parties free to agree the terms upon which oil or natural gas is to be transported or are the terms (including costs/tariffs which may be charged) regulated?

Generally speaking, gathering services shall be negotiated freely between the field operator and the carrier. CNH's model E&P Contract provides that the contractor may not lease any gathering lines that are indispensable for the regular commercial production; however, such contractor may obtain or provide services related to the shared use of these facilities.

7 Gas Transmission / Distribution

7.1 Outline broadly the ownership, organisational and regulatory framework in relation to the natural gas transmission/distribution network.

Transmission (understood as "Transportation" in the Mexican regulation) as well as distribution activities are subject to permits granted by CRE. When the transportation or distribution activity is performed through pipelines, it is subject to open and non-discriminatory access (please see question 2.1).

In 2012, 11,347 km of transportation NG pipelines operated in Mexico: 9,118 km operated by Pemex; and 2,229 km operated by private companies. Since 2012, 5,863 km of pipeline has been added to the national network and there are an additional 1,679 km under construction.

The CENAGAS (a recently created independent system operator of the State's NG pipeline system) led the first Open Season 2016–2017 to reserve transport capacity in the SISTRANGAS and promote effective open access to it. This event encouraged competition in the marketing activity and allowed the entry of new players in the market, for the benefit of final consumers.

The first annual auction of capacity available in in-bond pipelines was made on February 17, 2017 by CENAGAS, where it awarded 29.2% of the available capacity in interment/importation pipelines, which will allow the generation of greater investments with the entry of new actors to the gas market. Three companies were winners of 220,741 MMBtu/d on four routes of the NET Mexico Pipeline system, which is interconnected to the SISTRANGAS at the border compression station (Camargo) and supplies NG from Agua Dulce (Texas) to the National Gas Pipeline System and the Los Ramones Transportation System.

7.2 What governmental authorisations (including any applicable environmental authorisations) are required to operate a distribution network?

Pipeline transportation or distribution permits are required from an energy standpoint.

- Environmental impact assessment authorisation.
- Preparation of the SASISOPA.
- Social impact assessment.
- Indigenous communities' consultation, in certain cases.
- Archaeological authorisation, depending on the region.
- Authorisation to change the use of land in forest lands.
- Construction licence and other local and municipal authorisations related to the construction phase.

Though not authorisations themselves, two important actions related to government agencies are: (a) the securement of rights of way and their registration before the Public Registry of Property, so that the property titles of the relevant lands include the right of way granted for the pipeline; and (b) open access pipelines should favour the development of open season tender-type processes to allocate the capacity or size whether they need to expand a projected pipeline. This process is highly regulated in terms of the process, the timeline, and the results, and the applicant shall obtain CRE's approval before developing the tender.

7.3 How is access to the natural gas distribution network organised?

Access is guaranteed by open and non-discriminatory access to the transportation and distribution networks, which means that any interested party can request capacity on a system or an interconnection.

A significant achievement in the marketing of NG since the energy reform was the separation of NG transport and marketing activities. This means that permit-holders of transport by NG pipeline do not market the hydrocarbon.

Regarding the marketing of NG, as part of the asymmetric regulations imposed to Pemex, CRE submitted it to implement a Program of Gradual Assignment of Contracts, which establishes that within a maximum term of four years, Pemex should make available to third-party marketers the transfer of part of its portfolio of contracts representing 70% of its total volume of traded NG. The final phase of this programme occurred during 2018.

Distribution used to be arranged in different zones until late 2017, when CRE approved a single-zone scheme, and it is distinguished from transportation activities since its systems have a pressure of less than 21 kg/cm².

The regulations restrict distributors from supplying large consumers, but may do so through a marketer. The distributor can supply NG for residential use.

7.4 Can the regulator require a distributor to grant capacity or expand its system in order to accommodate new customers?

Pipeline operators subject to open access shall extend the route or expand the capacity of their systems, at the request of any interested party, provided that:

- i. the extension or expansion is technically feasible and economically viable in terms of the provisions of the regulation; and
- ii. the proposing party guaranteed the off-take of the service through the contractual vehicle provided by the operator in their GTCs.

The extension or expansion of the systems will be made with the prior authorisation for modification of the respective permit from CRE.

CRE has not issued the open access provisions that regulate distribution systems. There is no basis by which a distributor must be forced to develop or increase capacity. Some of the current distributors have exclusivity in certain geographical areas of the country.

7.5 What fees are charged for accessing the distribution network, and are these fees regulated?

Distributors that operate pipelines systems shall submit to CRE the proposed tariffs for the regulator's approval.

7.6 Are there any restrictions or limitations in relation to acquiring an interest in a gas utility, or the transfer of assets forming part of the distribution network (whether directly or indirectly)?

Generally speaking, there are no restrictions or limitations in connection to the acquisition of an interest in a gas utility. Please see section 11 for potential competition restrictions.

For the transfer of assets which imply a transfer of the permit, CRE's approval is required.

8 Natural Gas Trading

8.1 Outline broadly the ownership, organisational and regulatory framework in relation to natural gas trading. Please include details of current major initiatives or policies of the Government or regulator (if any) relating to natural gas trading.

Marketing activity requires a permit granted by CRE; contracting terms, conditions, and tariffs should be freely negotiated by the parties.

8.2 What range of natural gas commodities can be traded? For example, can only "bundled" products (i.e., the natural gas commodity and the distribution thereof) be traded?

Both bundled products or services can be freely traded by SPEs or private entities.

9 Liquefied Natural Gas

9.1 Outline broadly the ownership, organisational and regulatory framework in relation to LNG facilities.

LNG facilities are treated similarly to NG facilities. Storage of LNG is subject to open and non-discriminatory access. Moreover, transformation activities are subject to obtaining other relevant permits before CRE or SENER. Please see question 3.3. The NG liquefaction process has no open access obligations, so it does not entail a tariff or contractual regulation.

9.2 What governmental authorisations are required to construct and operate LNG facilities?

The permits and authorisations required differ on a case-by-case basis, depending on the specifications of the project.

The most common permits include liquefaction, storage, environmental impact assessment and risk, social impact assessment, SASISOPA, archaeological clearance, land use and zoning, earthworks authorisation and water rights, among others. Other ancillary permits or authorisations may include power generation, pipeline interconnection, and the approval of the proposed open season procedure.

9.3 Is there any regulation of the price or terms of service in the LNG sector?

There are regulated tariffs for LNG storage facilities. However, there is no tariff regulation in the liquefaction process or in LNG transportation by means other than pipelines.

9.4 Outline any third-party access regime/rights in respect of LNG facilities.

In the case of LNG storage terminals, there are open and non-discriminatory access obligations. In the case of liquefaction facilities, there is no obligation to provide services to third parties.

10 Downstream Oil

10.1 Outline broadly the regulatory framework in relation to the downstream oil sector.

Downstream activities, like marketing and retail sale, require a permit granted by CRE. The regulatory framework of downstream activities includes:

- a. The HL and its Regulations, which provide the general framework of the refining, transportation, storage, distribution, marketing and retail sale of hydrocarbons and refined products.
- b. DACGs for Open and Non-Discriminatory Access to Pipeline Transportation and Storage of NG and DACGs of refined products and petrochemicals, which allows downstream players access to logistics assets (with the exception of logistics for self-use).
- c. Public Policy on Minimum Stocks of Petroleum Products (please see question 2.1).
- d. Public Policy on Minimum Stocks of Natural Gas (please see question 2.1).
- e. Asymmetric regulations applicable to Pemex.
- f. Mexican Official Standard NOM-016-CRE-2016 on quality specifications of fuels throughout the value chain.
- g. A programme to register the SASISOPA for retail sale of NG, and retail sale or distribution of refined products and liquefied petroleum gas.

10.2 Outline broadly the ownership, organisation and regulatory framework in relation to oil trading.

Import and export of oil is subject to a permit granted by SENER. Marketing and sale of oil or oil products is subject to different permits, depending on the scope of the activity to be performed. Please see question 3.3.

11 Competition

11.1 Which governmental authority or authorities are responsible for the regulation of competition aspects, or anti-competitive practices, in the oil and natural gas sector?

In Mexico, competition enforcement began in 1993 with the enactment of the Federal Economic Competition Law (“FECL”) and the creation of a specialised antitrust agency within the Federal government. In 2013, constitutional amendments resulted in a new fully independent agency (“COFECE”) to monitor, promote and ensure competition and free access to the markets in all sectors and industries (except for telecom, entrusted to another agency). COFECE has powers to investigate and penalise monopolies (cartel behaviour and abuse of conduct) and illicit concentrations; regulating essential inputs or facilities, and eliminating barriers to competition, and other restrictions to the efficient operation of markets. Although COFECE’s transversal powers include the oil and gas sector, CRE has specific powers in certain competition matters in midstream and downstream, to promote the efficient development and competition of the industry, whereas CNH has similar powers in the upstream segment.

11.2 To what criteria does the regulator have regard in determining whether conduct is anti-competitive?

Generally, FECL and its regulations provide for *ex ante* (i.e., opinions for bidding guidelines, or merger control procedure), and *ex post* (investigations for cartel behaviour, monopolisation or illicit concentrations, recommendations for correction of market failures) mechanisms to prevent and sanction anti-competitive behaviour.

Mexican antitrust law has been substantially influenced by the U.S. and European laws on the subject.

In the oil and gas sector, where the goal has been to end Pemex’s long-held monopoly in all segments of the value chain and prevent new concentrations from occurring, the HL sets forth certain pre-emptive measures and asymmetric regulations to promote competitive markets such as legal, operative and accounting separation of vertically integrated entities and restriction of cross-ownership.

11.3 What power or authority does the regulator have to preclude or take action in relation to anti-competitive practices?

COFECE may investigate and punish conducts harshly with actual or potential anti-competitive effects in Mexican markets.

CRE may revoke permits for midstream and downstream activities upon a permit holder breaching a COFECE decision, as well as issuing regulations of tariffs and rates, until receiving COFECE’s favourable opinion on the existence of effective competition conditions.

11.4 Does the regulator (or any other Government authority) have the power to approve/disapprove mergers or other changes in control over businesses in the oil and natural gas sector, or proposed acquisitions of development assets, transportation or associated infrastructure or distribution assets? If so, what criteria and procedures are applied? How long does it typically take to obtain a decision approving or disapproving the transaction?

COFECE has pre-merger control powers in all sectors, including energy. Authorisation for a transaction shall be denied if it is

deemed to hinder, harm or impede competition and free market access regarding equal, similar or substantially related goods or services.

Concentrations must be notified when the transaction meets certain thresholds based on transaction size (approx. US\$70 million), and value of the assets and turnover in Mexico, as well as smaller transactions between larger companies.

12 Foreign Investment and International Obligations

12.1 Are there any special requirements or limitations on acquisitions of interests in the natural gas sector (whether development, transportation or associated infrastructure, distribution or other) by foreign companies?

In the case of oil and hydrocarbons in the subsoil, the property of the State is inalienable and imprescriptible, and no concessions will be granted. With the purpose of obtaining income for the State that contributes to the long-term development, the State will carry out the E&P activities through entitlements with SPEs (Pemex), or through contracts with these or with private entities.

As a result of the energy reform, restrictions to foreign participation were removed, with the exception of:

- supply of fuels and lubricants for aircraft; and
- the participation in cabotage activities, which could affect the participation of foreign entities in projects involving the offshore transportation of oil and gas and its derivatives.

12.2 To what extent is regulatory policy in respect of the oil and natural gas sector influenced or affected by international treaties or other multinational arrangements?

Mexico has several foreign trade agreements with other countries, the most important being the recently renegotiated agreement with the U.S. and Canada (“USMCA”). Although the final draft of such agreement has not been issued yet, public communications from the government explain that energy-related investments will be protected by the USMCA and that Mexico will ensure the open markets and free participation of private players.

Mexico and the U.S. have executed an agreement in connection with cross-border oil and gas deposits, where it is considered that there are up to 172 billion barrels of crude oil and 304 billion cubic feet of NG. This agreement obligates the two countries to exchange information when the existence of a cross-border deposit is detected or presumed. If proven, Pemex or the companies that participate on the side of Mexico would have to sign a “unitisation” agreement (unification of deposits) with the U.S. firms. Subsequently, it will be necessary to define what percentage corresponds to each side of the border, according to the location of the deposit and the corresponding expert reports. Both processes must be authorised by both governments before production begins.

13 Dispute Resolution

13.1 Provide a brief overview of compulsory dispute resolution procedures (statutory or otherwise) applying to the oil and natural gas sector (if any), including procedures applying in the context of disputes between the applicable Government authority/regulator

and: participants in relation to oil and natural gas development; transportation pipeline and associated infrastructure owners or users in relation to the transportation, processing or storage of natural gas; downstream oil infrastructure owners or users; and distribution network owners or users in relation to the distribution/transmission of natural gas.

The HL allows for E&P Contracts to provide for arbitration for the resolution of disputes thereunder, with the exception of disputes relating to the administrative rescission of E&P Contracts, which must be heard by Mexican federal courts.

The model E&P Contract provides: (a) arbitration (in practice, UNCITRAL rules have been used so far), conducted in Spanish, sitting in The Hague, Netherlands; or (b) in case of serious breaches listed in the model contract, administrative rescission by and before CNH, which includes the unauthorised transfer of rights under the contract, unjustified breaches in the Program of Minimum Works, intentional wrongful reports, among others. The model contract acknowledges that contractors have the rights contained in international treaties signed by Mexico (i.e., investment protection).

Midstream and downstream agreements can be subject to arbitration, federal courts of law, or any other dispute resolution mechanism. CRE has the power and authority to intervene in disputes, either through a mediation process or via claims filed by users of permit-holders (i.e., users of a pipeline transportation system).

13.2 Is your jurisdiction a signatory to, and has it duly ratified into domestic legislation: the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards; and/or the Convention on the Settlement of Investment Disputes between States and Nationals of Other States ("ICSID")?

Mexico has been part of the NY Convention since 1971 and recently signed the ICSID Convention in January 2018.

13.3 Is there any special difficulty (whether as a matter of law or practice) in litigating, or seeking to enforce judgments or awards, against Government authorities or State organs (including any immunity)?

There is no particular difficulty in the enforcement of judgments (local or foreign) and arbitral awards against the government or, for example, the SPEs, other than heavy workload of federal courts and delayed procedures.

It is noted that the most relevant causes of termination are handled in administrative rescission exclusively. There is no waiver of sovereign immunity by the Mexican government in E&P Contracts.

13.4 Have there been instances in the oil and natural gas sector when foreign corporations have successfully obtained judgments or awards against Government authorities or State organs pursuant to litigation before domestic courts?

Yes; *COMMISA vs. Pemex*, where Pemex was condemned to pay nearly US\$400 million to a contractor hired to build offshore platforms. Although the arbitral award has been issued, final quantification and enforcement is pending.

To date, and after the opening of the energy markets in 2013,

there has not been one particular case filed by a contractor against the Mexican government (CNH).

CRE and CNH, as part of their autonomy, have issued important resolutions that do not necessarily favour the SPEs, Pemex and CFE:

- CRE denied a petition by CFE to keep a percentage of the revenues generated in the gas pipelines, based on CFE's predominant market position.
- CRE initiated an investigation against CFE in connection with complaints of new players in the electricity sector, in relation to CFE's delays in executing connection agreements to the national grid.
- CRE fined Pemex twice in 2017, (i) for not complying with the specifications of fuels, and (ii) for not granting non-Pemex truck carriers access to its facilities for delivery of refined products. Each fine was for an approximate amount of US\$400,000.
- Pemex tried to retain all the capacity in port terminals against open-access; however, CRE forced the SPE to grant access in favour of competition.

14 Updates

14.1 Please provide, in no more than 300 words, a summary of any new cases, trends and developments in Oil and Gas Regulation Law in your jurisdiction.

On the fifth anniversary of the energy reform:

- A total of 111 E&P Contracts have been signed with CNH. Expected investments in upstream amount to approx. US\$160 billion; 67 contracts related to seismic studies activities will initiate investments of US\$2.1 billion.
- Eighty-six contracts to exploit renewable sources such as solar, wind or geothermal will provide US\$8.6 billion.
- The South Texas-Tuxpan submarine pipeline has entered into operations. Such gas pipeline allows the supply of NG to the centre and south of the country.
- CFE contemplates the construction of five new combined cycle generation plants.
- There is interest from several national and international companies in building about 48 storage terminals for hydrocarbons and refined products.
- For the first time, a floating production, storage, and offloading ("FPSO") unit will operate in Mexico for a private company; the FPSO will be capable of processing 90,000 barrels of crude oil per day, 75 mmcf, 120,000 barrels of water injection per day and have a storage capacity of 900,000 barrels of crude oil.
- CRE authorised a liquefaction permit for a Semptra group company. Their plant is located in Ensenada, Baja California, in the facilities that were previously dedicated to the import and regasification of LNG.
- After economic and environmental discussions, SENER will coordinate the construction of a refinery in the port of Dos Bocas in the State of Tabasco.
- The possible integration of all transport systems into the SISTRANGAS operated by CENGAS is under discussion.

14.2 Please provide a brief comment on the impact (if any) of the “energy transition” on the oil and gas industry in your jurisdiction.

Mexico signed and ratified the Paris Agreement on climate change; however, the new administration of Mexico under President López Obrador has made decisions that may be perceived as being opposed to such international commitments. Part of the new policy seeks to favour fossil fuels and Mexico’s state-owned petroleum company, Pemex.

Some of these changes are driven by a new budget allocation for the “modernisation” of coal, diesel, gas and oil power plants, some of which the previous administration had already

scheduled for decommissioning. Likewise, it has suspended the procedures for electric auctions designed to promote power generation projects through renewable sources. Moreover, the generation infrastructure expansion plan of CFE proposes the construction of five combined cycle power generation plants.

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