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PETRÓLEOS MEXICANOS (PEMEX)

President Felipe Calderón of Mexico announced Wednesday that the national oil company, Pemex, had struck oil in deep water, its first success after years of exploration in the deeper reaches along the bottom of the Gulf of Mexico. The find, deep below the Gulf's floor and more than 8,200 feet below the surface of the water, could add as much as 400 million barrels in potential reserves to Mexico's overall reserves, Mr. Calderón said at a ceremony at Los Pinos, his official residence. But perhaps even more important than the amount is the fact that Pemex, a monopoly, found the oil on its own.

Mexican law prevents Pemex, which is officially called Petróleos Mexicanos, from forming partnerships with outside companies. Critics have argued that the company lacked the experience to successfully explore in deep waters.

For Mr. Calderón, the announcement was vindication in the final months of his presidency that the deepwater strategy was worth the gamble. Holding up a vial of light crude from the well, he said: "What a good thing that this effort is crowned today, with a great discovery, with the realization of a goal that we had set for ourselves."

*"Pemex Finally Strikes Oil in Deep Waters," by Elisabeth Malkin,
The New York Times, August 29, 2012.*

... the Chairman of the Mexican Stock Exchange (BMV), Luis Téllez, says oil is the country's most inefficient industry. Mr. Téllez believes it is therefore essential to leverage the power of the stock market to increase the company's competitiveness, which would allow it to capitalize on a buoyant economy and strong investor appetite. "We were taught at school that Pemex belonged to the Mexican people, yet there is not a single Mexican citizen who holds shares in the company."

"PEMEX Can Be More Competitive; The Stock Market Would Boost the Oil Company's Value," POR Diana Fernández, Funds Americas, March 30, 2012.

Petróleos Mexicanos—Pemex—was struggling. The national oil company of Mexico, Pemex held total reign over the Mexican oil and gas industry. The largest company in Latin America, it employed 140,000 people, made up 3% of Mexico's GDP, and provided nearly 40% of the funds for the Mexican government's budget. Although jubilant over its recent deepwater discovery (described above), production of oil and gas had been dropping for years, and its single largest field, Cantarell, was in rapid decline.

Pemex had been a cash cow for the Mexican state, but was notoriously inefficient and corrupt. The newly elected President, Enrique Peña Nieto, had long argued that private investors should be allowed back into the Mexican oil and gas industry—in some way. He was feeling pressure from inside Mexico, from Mexican industry particularly, and from outside Mexico, for example the United States, and calls for a Transboundary Agreement for joint ownership of deepwater oil in the Gulf of Mexico. Everyone believed Pemex needed to change, but the question was how? Juan José Suárez Coppel, General Director of Pemex, acknowledged that the company had underperformed in the past, but that many significant changes had been made and it was now turning the corner. Was change really needed?

Mexico and Oil

Oil and Mexico did not mix, at least well, historically.

Those following Mexican President Felipe Calderón Hinojosa's energy reform efforts would probably respond that to talk about oil in Mexico is not to refer to a resource below ground or the country's geographical wealth. Instead, oil represents something largely symbolic. It is an important part of the mythological construction of an independent nation, and it is also associated with the underworld of corruption in Mexico. The mere mention of oil stirs up both a strong nationalistic pride and feelings of profound distrust.¹

The Mexican oil industry was one of the oldest by industry standards, with oil exploration and production beginning in the 1870s. Led largely by American and British companies, Mexico had become the world's second largest producing country by the early 1920s, with a quarter of all global production. But production began to decline rapidly, and as industry returns declined, relations between the private industry developers and Mexican labor and government worsened. On March 18, 1938, in the midst of a major oil worker strike, President Lázaro Cárdenas surprised the foreign oil companies operating in Mexico by expropriating the entire oil industry.²

Mexican oil was the property of the state according to the Mexican Constitution of 1917. Article 27 of the Constitution granted all permanent and complete subsoil rights to the government.³

Article 27. Ownership of the lands and waters within the boundaries of the national territory is vested originally in the Nation, which has had, and has, the right to transmit title thereof to private persons, thereby constituting private property.

... In the case of petroleum, and solid, liquid, or gaseous hydrocarbons, no concessions or contracts will be granted, nor may those that have been granted continue, and the Nation shall carry out the exploitation of these products, in accordance with the provisions indicated in the respective regulatory law.

The nationalization of 1938 gave the Mexican government exclusive rights over the exploration, development, production, and refining of hydrocarbons. Two months following expropriation, President Cárdenas created Petróleos Mexicanos (Pemex), making it the organization responsible for all of these upstream oil and gas activities.

Even after expropriation, Pemex continued to use private contractors to fill the void in needed technology, capital, and operational execution. Much of this work was performed under risk-service contracts, where contractors were paid, in part, with percentages of production.⁴

This era ended with the administration of President Ruiz Cortinas in 1958. The Petroleum Law of 1958 expressly prohibited contractor compensation in anything but cash. Contractors could not be paid on the basis of percentage of production, participation in production or sale, or the result of exploration activities. This eliminated the use of risk-service agreements. The law of 1958 extended Pemex's exclusive rights over hydrocarbons to the downstream, the manufacture and sale of petroleum products.

Over the next 25 years, Pemex grew as a domestic bureaucracy, expanding its production and refining activities with varying levels of success. Pemex was increasingly seen as an organization representing Mexico's sovereignty and future prosperity, in many ways an embodiment of "the people's struggle" against repression. The organization and its bureaucracy continued to grow, expanding employment, compensation, often more under the control and influence of labor than the federal government.

With the surge in global oil prices in 1973-1974, Pemex came under new pressure to expand production, which it could not do without finding and developing new fields. Despite a renewed emphasis on exploration, the single largest discovery was made by accident. In 1976, a fisherman by the name of Rudesindo Cantarell noticed an open water oil seepage in the Bay of Campeche. Only after repeated complaints about the oil seepage

¹ *Oil in Mexico: Pozo de Pasiones, The Energy Reform Debate in Mexico*, Rossana Fuentes Berain with Daniel Rico, Woodrow Wilson International Center for Scholars, Mexico Institute, 2009.

² "The Void of Governance: An Assessment of Pemex's Performance and Strategy," Ognen Stojanovski, Program on Energy and Sustainable Development, Stanford University, Working Paper #74, April 2008, p. 10.

³ *The Mexican Constitution and its Safeguards against Foreign Investments*, Alvaro Ramírez Martínez, American University, Cornell Law School Inter-University Graduate Student Conference Papers, 4-14-2009.

⁴ "Energy Reform and the Future of Mexico's Oil Industry: The Pemex Bidding Rounds and Integrated Service Contracts," Tim R. Samples and José Luis Vittor, *Texas Journal of Oil, Gas, and Energy Law*, Vol. 7, July 21, 2012, p. 223.