A Major Upgrading of Mexico’s Refining Capacity
An array of business opportunities
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I. CURRENT SITUATION OF MEXICO’S PRODUCTION OF OIL DERIVATIVES.

MEXICO’s refining system is formed by six refineries across the country and it has been thirty years since the last one was built. Although Mexico is the sixth largest crude oil producer in the world, during the first semester of 2008, Cantarell field’s production reached 2,856,000 barrels a day (b/d), an output 9.7% smaller than 2007’s and the smallest level of production for one semester in more than 10 years.

As a result of the foregoing, Mexico’s imports of fuel have rapidly grown in the last six years to reach 340,000 b/d in 2008, an amount representing 42.5% of the entire national consumption and a governmental expense of US$14.4 billion. In fact, in 2008, such expense increased about 40% with respect to 2007. Furthermore, it is estimated that Mexico will require an additional refining capacity of 600,000 b/d in 2015.

In this context, Petróleos Mexicanos (Pemex), Mexico’s state-owned oil company, has announced its mid-term projects which are expected to foster its refining capacity to meet future demands of oil derivatives.

Conversely, between 1980 and 2008, Mexico’s demand of fuel has markedly grown at an approximate annual rate of 3.4%, being Mexico’s center-west region the greatest consumer, amounting to 60% of national consumption but having a deficit in the supply of about 57%.
II. PEMEX’S INVESTMENT PROJECTS: CONSTRUCTION OF A NEW REFINERY AND UPGRADE OF EXISTING REFINERIES.

On May 2009, Pemex informed its main challenges with respect to its refining capacity and announced its most relevant mid-term projects for the years 2009-2012, among which the following are included (i) the termination of the works carried out in Minatitlán, Veracruz to upgrade its refinery, (ii) the construction of the new refinery in Tula, just announced last April, (iii) the commencement of the works to upgrade Salamanca’s refinery, and (iv) the improvement of the environmental characteristics of its fuel which will simultaneously require the construction or upgrading of 39 oil-refinery plants, amongst others.

Construction of the new refinery
As established in Mexico’s National Development Plan (Plan Nacional de Desarrollo 2007-2012) for the energy sector, and about 13 months after the President of Mexico instructed Pemex to commence a thorough research and assessment on the technical, economic and logistic feasibility which in turn would permit it to select the site for building a new refinery in Mexico and thus increase its refining capacity, on April 14, 2009, Pemex’s General Director announced the site where the new refinery will be located.

The referred assessment concluded that Tula, State of Hidalgo stood as the most feasible and profitable location for the construction of the new refinery, taking into consideration two crucial variables:

(i) the distance from the nation’s greatest consumption market of fuel (Mexico’s center-west region), and
(ii) the fact that it exists an important profit to the extent that the new refinery could use residuals currently produced in Salina Cruz, Oaxaca; Salamanca, Guanajuato, and in Tula itself, as raw material. The construction of the new refinery is expected to commence in late 2010.

The new refinery will have a maximum refining capacity of 300,000 b/d and it would produce around 142,000 b/d of gasoline, 82,000 b/d of diesel and 12,000 b/d of jet fuel, all of which will have ultra-low sulfur content. The construction of the new refining capacity will represent a governmental investment of around US$9.1 billion and it also entails the construction of pipelines and related infrastructure to connect it to demand centers.

Upgrading existing refineries, improvement of the quality of the fuel and other projects
The strategy announced by Pemex not only included the above referred construction but also the upgrading of existing refineries to increase the domestic output of ultra-low sulfur content fuel as well the expansion of Pemex’s storage and transportation capacity.

The most relevant projects are:

<table>
<thead>
<tr>
<th>Project</th>
<th>Objective and scope of the project</th>
<th>Investment 2009 (MMUSD)</th>
<th>Investment for 2009-2012 (MMUSD)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Upgrading of Minatitlán’s refinery</td>
<td>- Increase the production of ultra-low sulfur content fuel; and - Construction of 9 processing oil refinery plants and related infrastructure.</td>
<td>537</td>
<td>537</td>
</tr>
<tr>
<td>Upgrading of Salamanca’s refinery</td>
<td>- Increase (i) the capacity to process fuel oils, (ii) the production of distilled fuels with a higher value; - Reduce the production of fuel oils; and - Construction of 8 new oil refinery plants.</td>
<td>279</td>
<td>2,209</td>
</tr>
</tbody>
</table>
## III. ECONOMIC EFFECTS: AN ARRAY OF BUSINESS OPPORTUNITIES.

The investment portfolio announced by Pemex, will represent a governmental expense of approximately US$16,631 billion during the years 2009-2012 and it is estimated that only the construction of the new refinery will create approximately 10,000 direct jobs and 35,000 indirect jobs.

It is anticipated that the first stage of the construction of the new refinery will benefit consulting firms which will eventually participate in the preparation of the technical requirements for the public bidding process and the primary assessments of the new infrastructure. In fact, US$630 million –which amounts to 5% to 7% out of the US$9.1 billion to be invested by the government for the construction of Tula’s new refinery– are expected to be channeled for the works to be carried out in this first stage.

Furthermore, it is estimated that less than 5% of the total works for this first stage will be carried out by domestic consulting firms since the same are not fully experienced in the detailed engineering process related to the construction of refineries. Hence, it is very likely that foreign consulting firms will perform the vast majority of works related to such detailed engineering.

Beyond question, the announced Pemex portfolio opens a wide array of business opportunities for registered national and international Pemex’s contractors and subcontractors with respect to the commercialization of a broad variety of goods and services related to, amongst others, the following:

- Design, basic and detailed engineering and construction of the refining processing facilities and related infrastructure;
- Piping design and evaluation, installation, repair and modification of pipeline systems;
- Transportation services;
- Acquisition of industrial systems, controls and processes usually found in refineries of this type, such as (a) atmospheric distillation unit, (b) process control to monitor the different industrial processes, (c) catalytic reformer, (d) fluid catalytic cracker unit, (e) SCADA system for chemical processes, (e) HVAC system, amongst others.

<table>
<thead>
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<th>Project</th>
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</tr>
</thead>
<tbody>
<tr>
<td>Pipelines system</td>
<td>• Enlarge the capacity to transport and optimize the existing infrastructure; and • Construction of oil pipelines in Madero-San Luis Potosí’s (394 km), and in Mazanillo-Guadalajara (314 km);</td>
<td>-</td>
<td>730</td>
</tr>
<tr>
<td>Terminals</td>
<td>• Increase the storage capacity and mitigate risks to the society; and • Relocation of 2 terminals (Tapachula and Reynosa) and construction of two terminals (Caribe and Valle de México).</td>
<td>4</td>
<td>99</td>
</tr>
<tr>
<td>Renewal of tank trucks</td>
<td>• Modernize Pemex’s fleet of tank trucks; and • Replacement of 1,105 tank trucks, out of which 529 will be replaced during the years 2009-2010.</td>
<td>36</td>
<td>60</td>
</tr>
</tbody>
</table>
IV. PEMEX’S CONTRACTORS LEGAL FRAMEWORK.

The acquisition, leasing and the provision of services as well as the public works and services related thereto which are required by Pemex, must ensure it the best conditions available in the market with respect to price, quality, financing, opportunity and any other relevant circumstance.

The applicable legal framework to execute said acquisitions may vary depending on whether or not the relevant acquisition is related to Pemex’s substantive activities as provided by law. In general terms, however, Pemex’s referred acquisitions are carried out as a general rule through public biddings, and exceptionally through (i) a direct awarding procedure, or (ii) a closed invitation procedure.

Owing to the recent amendments in Pemex’s legal framework, it is projected that Pemex contracting related to the construction of the new refinery will be carried out through the implementation of the new execution models (NEM) created as a result of such amendments. Among NEM’s most important characteristics and figures are the following:

- NEMs are exclusively service agreements – as opposed to production sharing or equivalent features;
- A Master NEM: One large contractor and subsequent private contractors;
- A set of NEMs divided according to functions and regions: Various large contractors for specific blocks or groups of services;
- Credit rating: The bidder is required to submit a document issued by a certified rating agency registered before the National Banking and Securities Commission (Comisión Nacional Bancaria y de Valores), containing an approved rating (i.e. C+: Fitch or Caa: Moody’s);
- Environmental considerations: Initial and final environment indicative reports must be filed as well as annual environmental reports;
- Consortium leader: Proposals may be submitted on behalf of an entire consortium, which in turn will designate a leader. This leader will be responsible for the communication sustained with Pemex and for the joint obligations entered into by other consortium’s members;
- Annual Work Programme (Programa Anual de Trabajo – PAT): It refers to the work scheduled and its related budget which must be annually made by the bidder. Together, several PATs compose the Master Execution Program which contains, at a basic level, the execution schedule of the different PATs;
- Management group: This group is formed by 3 members of Pemex and 3 members of the contractor and is responsible for proposing, discussing and evaluating all those technical assistance activities for Pemex, scheduling of works, coordinating Pemex and bidders, applying ICD and other related matters;
- Directive group: This group is integrated by 3 members of Pemex and 2 members of the bidder. The group meets to resolve any topic related to the contract or any difference derived from the Management Group. In order to so it may require the assistance of independent experts;
- Performance indicators (ICD): They are specific to each phase of the contract and allow for the evaluation of the safety, the environmental and health conditions, and the reliability of the administration’s performance;
- Guarantees: Several guarantees must be issued such as: (i) corporate guarantee, (ii) hidden and latent defect guarantee, and (iii) fulfillment guarantee depending on which requirements each company meets; and,
- Non-subcontractable items: job planning, onsite job direction, and performance evaluation in meetings with Pemex.
Execution of agreements

The execution of the public works and services agreements with either individuals or legal entities by Pemex will be subject to the following:

- Hydrocarbons and oil reserves will remain property of the Nation. The State will maintain at all times the control and direction of the oil industry.
- It shall not be granted preference rights of any kind whatsoever for the purchase of oil and its derivatives.
- The consideration to be paid under the relevant agreements shall be subject, amongst others, to the following conditions:
  a) It shall be in cash.
  b) It shall be reasonable in line with the use and standards of the industry.
  c) It shall be established as a fix amount or as a predetermined formula the outcome of which is a certain consideration.
  d) It shall be included penalties in respect of (i) the negative impact to the environment of the relevant activities of the contractor, or (ii) lack of compliance with indicators of opportunity, time and quality.
  e) Additional compensation to the contractor may only be agreed upon when:
     1. Such contractor obtains a budget cutback due to the reduction in the time of execution of the works,
     2. Pemex acquires or receives a benefit from new technological advances provided by the contractor, and
     3. Other circumstances attributable to the contractor concur which may represent an additional profit to Pemex or a better result in the works or services.

The possible additional compensations shall be expressly established at the time of execution of the agreement.

- The agreements may include provisions whereby the parties may make amendments to the projects for or owing to (i) the incorporation of new technological advances, (ii) variation in the market prices of materials and equipments used in the corresponding works, (iii) the acquisition of new information obtained during the execution of the works, or (iv) others which may contribute to the efficiency of the relevant project.

Undoubtedly the announced investment scheme offers important business opportunities for companies wishing to participate in any of the projects described above, either as Pemex’s contractors or subcontractors. At Goodrich Riquelme y Asociados we can help you out in identifying such business opportunities, and in the preparation of creative legal solutions in order to accomplish your business objectives.

With a solid experience, our firm is duly prepared to assist its clients interested in the oil and gas sectors. The firm’s Energy Practice Group is focused on providing comprehensive assistance to PEMEX’s contractors and sub-contractors with respect to public biddings, corporate structuring, and transnational commercial arrangements, amongst other services related to upstream and downstream operations. Likewise, Goodrich’s finance, banking and venture capital experts help clients to structure their businesses in the most efficient way by focusing on minimizing regulatory obstacles while at the same time complying with the applicable regulations.
With 75 years of experience and being amongst the five largest law firms in Mexico, Goodrich Riquelme y Asociados has a long tradition of standing alongside its clients when helping them make their business objectives a reality. By means of a cross practice amongst service areas and industry teams, our carefully trained lawyers achieve an innovative approach towards the rendering of contemporary legal services tailored to the demanding business community worldwide.

We ensure that our clients are competently represented wherever their businesses take them. This is why, in addition to our network of correspondents in Mexico and our own office in Paris (since 1971), Goodrich actively participates as founder firm of the Bomchil Group, an association of independent law firms with offices in practically every Latin American country. Today, Goodrich has a professional and administrative staff of over 250.

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