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# State-run Oil Company PEMEX, Hydrocarbons Regulator Disagree on Deepwater Drilling

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The state-run oil company PEMEX and the Comisión Nacional de Hidrocarburos (CNH), the autonomous government agency that regulates oil policies in Mexico, are at odds on whether it is wise for Mexico to proceed with plans to access oil reserves in the deep waters of the Gulf of Mexico. In early May, the CNH issued a report critical of the high cost and high risk of deepwater drilling. The report, which examined the profitability and risk factor of 383 exploration and extraction projects, found the least financial risk in ventures that took place in shallow waters. In contrast, the CNH raised strong concerns about the financial and safety risks of deepwater projects, including the potential for disaster.

PEMEX—which for decades made decisions without input from anyone but the president, the energy secretary, and key legislators—recently had to surrender some of those policymaking faculties to the CNH. President Felipe Calderón's administration created the CNH in 2009 to allow more technical and independent oversight of the industry.

## *Exploratory wells planned near maritime border with US*

The recent CNH report could not have come at a worse time for PEMEX, which had announced plans to begin two major exploration activities in the deep waters of the Gulf of Mexico sometime in May. The company had started to make preparations to deploy two state-of-the-art drilling platforms to an area just south of the maritime boundary with the US to drill a couple of exploratory wells sometime during the month. The semi-submersible platform West Pegasus, owned by Norwegian company Seadrill, was to be deployed to the area just over a seabed formation known as the Perdido Fold Belt to drill an exploratory well known as Supremus-1.

A second well was to be drilled in the vicinity of the Bicentenario platform, which is owned by Mexican company Grupo R. The well, known as Trion-1, will be a little west of Supremus-1.

The two exploratory wells represent PEMEX's latest efforts to expand its deep-sea drilling operations, which were begun in 2004. The company has drilled 16 wells in the past eight years at increasing depths. Two of those wells, Caxa-1 and Kunah-1, are in waters considered "ultra-deep." But the well depths of 8,316 feet for Trion-1 and 9,514 feet for Supremus-1 far surpass the depth of 6,500 feet for Kunah-1, which is in the Catemaco Fold Belt.

There is a difference of opinion between the CNH and PEMEX on whether the oil company is sufficiently prepared for the challenges of drilling deepwater wells. The CNH contends that PEMEX is moving forward without the adequate expertise and experience in developing wells that are deeper than 6,000 feet.

Part of the problem, some experts note, is that the Mexican Constitution prohibits PEMEX from entering into joint ventures with companies that are already experienced in deepwater drilling.

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Instead, PEMEX has moved to hire global-oil-services companies to perform the exploratory activities while remaining in charge of the operations. Even this type of arrangement was not possible until the Mexican Congress approved a major reform of PEMEX, allowing the use of private contractors to perform specific tasks (SourceMex, Oct. 29, 2008, and Dec. 15, 2010).

Still, some experts believe that PEMEX is over its head with the deepwater-drilling projects. "This requires managerial expertise that PEMEX lacks," said Miriam Grunstein Dickter, who follows oil-industry policy at the Centro de Investigación y Docencia Económicas (CIDE) in Mexico City. "When you contract a service company, it performs the work that you command it to perform. Here, Pemex does not know how to command the service company."

## *Regulator concerned about safety*

But the CNH is also concerned about safety and the possibility that PEMEX might not be able to respond to a disaster similar to the one that occurred at British Petroleum's Deepwater Horizon drilling rig in April 2010, which resulted in a massive oil spill off the coast of Louisiana (SourceMex, May 12, 2010). The accident killed 11 workers and released 4.9 million barrels of oil during the three-month period before the spill was contained. BP estimates the cleanup operation—including fines paid to the US government—-at about US$42 billion.

US authorities were able to deploy some 3,000 vessels to help set booms, clean marshes, and collect spilled crude.

But CNH director Juan Carlos Zepeda is concerned that Mexico's capabilities are much smaller, even though the US and other countries could eventually step in with assistance. Furthermore, Zepeda noted that the CNH has very little capacity to enforce safety regulations, since the agency has a budget of only US$7.3 million, about 2% of what the US spent on similar efforts in 2011.

Carlos Morales Gil, director of PEMEX subsidiary Pemex Exploración y Producción (PEP), counters that the state-run oil company has the capability to comply with the CNH rules and to meet safety standards. He says PEMEX allocated about 4.5 billion pesos (US$327 million) between 2007 and 2011 for safety-related operations in the Perdido Fold Belt. The expenditures were intended to "reduce the geologic risks and to give economic certainty to this project," Morales told BNAmericas. Among other things, he said, PEMEX acquired sophisticated seismic equipment.

Furthermore, said Morales, the rigs being used for the Supremus and Triton wells are both "sixth generation, which means they are the most modern. They have all the safety devices that rigs should have."

"PEMEX is ready to undertake the challenge and to do it safely," Morales said in an interview in Mexico City with McClatchy newspapers.

Morales also disputed the claim that PEMEX is an inexperienced company. "You have to bear one thing in mind," he said. "PEMEX is the biggest operator in the Gulf—including everyone—both in production and in the number of rigs we operate. We are operating more than 80 rigs offshore."

Another disagreement between CNH and PEMEX is on whether the company has sufficient insurance to pay for even catastrophic spills. The CNH did not say what level of coverage is adequate, but Morales said PEMEX has coverage of US$2.5 billion. "I feel comfortable with what

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PEMEX is capable of doing. You can always argue that US$2.5 billion is not enough. We can always argue that US$10 billion is not enough," said the PEP executive.

Some industry experts note that PEMEX, which must justify expenses to the Mexican Congress, is reluctant to spend more on insurance. "They are probably thinking, 'why are we going to give all this money to the insurance company?'" said consultant David Shields, a respected energy consultant in Mexico City.

There is also a sense of urgency for PEMEX to find new sources of crude oil, since Mexico's reserves have fallen sharply in recent years. By some estimates, PEMEX is trying to compensate for a precipitous drop in the Canterell oil field, which left the country with the equivalent of 10 years of proven reserves of crude oil (SourceMex, March 7, 2007).

"[Mexican officials] consider it their duty to elevate crude production," said Fabio Barbosa, an economist at the Universidad Nacional Autónoma de México (UNAM). "They are moving about, driving production in every way they can."

But Shields believes there are other motivations, including the perception that deep-sea reserves are accessible, as evident with the fast development of US offshore wells in the Gulf of Mexico. "They want to put the flag there," said the energy consultant. "The oil industry is a lot like that. They want to go after bigger and bigger challenges. Once you go up a small mountain, you want to go up a bigger mountain."

Rather than compete with each other for reserves along their common boundary in the deep waters of the Gulf of Mexico, the US and Mexico signed an agreement earlier this year establishing a framework for US energy companies to work jointly with PEMEX (SourceMex, Feb. 22, 2012).

## *Presidential candidates discuss PEMEX*

PEMEX's fate has also become a hot-button issue during this year's presidential campaign. Three of the candidates— Enrique Peña Nieto of the Partido Revolucionario Institucional (PRI), Josefina Vázquez Mota of the governing pro-business Partido Acción Nacional (PAN), and Gabriel Quadri of the Partido Nueva Alianza (PANAL)—have come out in support of continued private involvement in PEMEX activities.

Andrés Manuel López Obrador, who represents a coalition of center-left parties, opposes private investment in PEMEX and believes that the company has the resources to perform all needed tasks without having to rely on private capital. One way to do so, he said, is to end the corruption that has stolen PEMEX's revenues. The center-left parties opposed the PEMEX reforms in 2008 that allowed the company to enter into multiple-services contracts with private companies.

During the first presidential debate on May 6, López Obrador directed his criticisms at Peña Nieto, who has made it clear that he favors the use of private capital to help the oil company expand and enhance its operations (SourceMex, Nov. 30, 2011).

López Obrador suggested that Peña Nieto would allow private companies to make profits on Mexico's oil resources. "Why do they favor Peña Nieto?" asked the center-left candidate. "Because they want to continue making juicy profits….Peña Nieto has told them that he is going to privatize PEMEX. But he hasn't read Article 27 of the Constitution, which states that PEMEX does not belong to the government, but to the nation."

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Peña Nieto disputed the assertions from his center-left rival. "I have not spoken of privatizing, but modernizing, PEMEX," said the PRI candidate. "This is what other countries have done. With the participation of the private sector, we can generate wealth."

Vázquez Mota spoke about her plan to open PEMEX to Mexican citizens through the sale of special bonds to the public. "I want PEMEX to be an industry for all Mexicans," said the PAN candidate. [Peso-dollar conversions in this article are based on the Interbank rate in effect on May 16, 2012, reported at 13.70 pesos per US$1.00.]

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