Deregulation and Mexico's Energy Bill reforms: stepping up to the new reality
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BACKGROUND

Historically, the private sector was allowed active participation in the energy industry. In 1938 and in 1960 this situation changed substantially. In 1938, the oil and gas industry was nationalised. The same occurred with the electricity industry in 1960. From this time onwards, the energy sector in Mexico was dominated by the state.

With regards to the oil and gas sector, the Mexican Constitution and legal framework provided, until December 2013, that the Mexican state (through Petróleos Mexicanos (Pemex) Mexico’s NOC) was the only entity permitted to perform the extraction and production of hydrocarbons in Mexico. Private parties could participate in these activities merely as service contractors. Similarly, midstream and downstream activities could only be performed by Pemex, with the exception of downstream activities associated with natural gas (storage, distribution, transportation and commercialisation), which could be performed by private parties through a permit granted by the Energy Regulatory Commission (Comisión Reguladora de Energía (CRE)).

As of 2008, the upstream legal framework was modified to allow Pemex to enter into integral exploration and production services contracts under conditions intended to be more attractive to international companies (both IOCs and oilfield service companies). These types of contracts resemble a risk-sharing contract, with the caveat that Pemex would share the risk but not the upside of the business. The effects sought by the 2008 reform were not met as the first three bidding rounds of the “new” E&P contracts were not attractive enough for IOCs. The E&P service contracts ended up being awarded to oilfield service companies and not to IOCs.

Until December 2013, the electricity sector was similarly dominated by the state. The state, through Mexico’s National Electricity Company (Comisión Federal de Electricidad (CFE)) was the only entity allowed to:
- Provide a public electricity service.
- Sell electricity in the wholesale market.
- Transmit the electricity through the national electricity system.
- Meter and commercialise electricity.

Private parties were not allowed to generate energy or sell it, except in cases authorised by law. Essentially, the only cases where the law authorised the private sale of energy was when a private party generated energy with the purpose of selling it (small producers) to the state (that is, the CFE), for the purposes of exportation, or when it generated energy for its own consumption (self-supply) and there was a surplus to be sold. In that sense, a common scheme that private parties developed to participate in the electricity market was through “self-supply companies”. Under this structure, a developer would promote a generation project to a number of companies, all of which would, along with the developer, jointly form a special purpose company (SPC). This SPC would then secure a self-supply permit from the CRE, enabling it to generate and sell by credit to its shareholders or equity holders. Until December 2013, that was the only way in which a private party could generate and sell electricity to a private party.

CONSTITUTIONAL ENERGY REFORMS

On 20 December 2013, the Mexican Federal Congress passed constitutional amendments that paved the way for a complete overhaul of the legal framework governing the energy sector in Mexico. The amendments have now also been approved by a majority of the legislatures in Mexico’s 32 states. Although hailed in the main for finally allowing private sector participation in hydrocarbon upstream activities, the amendments also deregulate downstream activities and allows private participation in the generation and supply of power.

Under this new constitutional framework, the Mexican state will continue to hold a monopoly over exploration and extraction activities, and all hydrocarbons in the subsoil will continue to be owned by the nation. However, the state can enter into several types of contracts, such as production sharing, profit sharing, licences and other types of service arrangements with private parties to perform E&P activities on behalf of the state. In the electricity field, private parties will be able to participate as generators. Transmission and distribution will still be controlled by the state through an entity separate from the CFE, the National Centre for Electricity Control (CENACE). However, private parties will be able to participate in transmission and distribution activities with CENACE or other government entities through public and public private partnerships (PPPs) or other types of contractual arrangements.

Pemex and the CFE will be converted into state productive companies (SPCs) from their current status as decentralised government entities and will be granted sufficient autonomy to act with budgetary and operational independence. Among the most important features of the new Pemex and CFE (as well as other SPCs that may be created), is that employee compensation will no longer be limited by constitutional restriction to an amount not exceeding the President’s salary. Employees can be offered competitive salaries and bonuses, a feature that will allow Pemex and CFE to retain talent and properly foster and recognise productivity. In addition, Pemex and CFE employees will be subject to rules that permit administrative flexibility and that subject entities to more efficient procurement standards. These changes are designed to allow Pemex and CFE to compete with other companies to secure contracts from the state and to sell power in the wholesale market.
In the hydrocarbon area, both international oil companies and services companies will be able to enter into different types of contracts with the state to perform E&P activities on its behalf. These contracts include:

- Services.
- Profit-sharing.
- Production sharing.
- Licences (whereby a contractor will be entitled to purchase from the state, the oil actually produced).

However, none of these agreements will grant contractors any ownership rights over production, and the booking of benefits under the contracts will be permitted so long as it is clearly stated that contractors have no rights over reserves.

Articles that are transitory in nature to the constitutional amendments require the passing of fully implemented laws within the year following the date when the amendments become effective, though the most substantial part of the implementation laws must be passed within the initial four months.

On 29 April 2014, the Mexican Executive submitted to the Mexican Congress nine bills that encompass the secondary laws required to implement the principles of the December 2013 constitutional reform, collectively known as the Energy Bill:

- A new Hydrocarbon Law (Ley de Hidrocarburos) and amendments to the Foreign Investment Law (Ley de Inversión Extranjera (FIL)), the Mining Law (Ley Minera) and Public and Private Partnership Law (Ley de Asociaciones Público Privadas).
- The Electricity Industry Law (Ley de la Industria Eléctrica) (Electricity Law).
- The Law for the Coordinate Energy Regulatory Agencies (Ley de Órganos Reguladores Coordinados en Materia Energética) (Energy Regulators Law) and an amendment to the Organic Law of Public Administration (Ley Orgánica de la Administración Pública Federal).
- The Petroleos Mexicanos Law (Ley de Petróleos Mexicanos) (Pemex Law) and the Comisión Federal de Electricidad Law (Ley de la Comisión Federal de Electricidad) (CFE Law) and amendments to the Government Entities Law (Ley Federal de Entidades Paraestatales).
- The Geothermal Energy Law (Ley de Energía Geotérmica) (Geothermal Law) and an amendment to the National Water Law (Ley de Aguas Nacionales).
- The Hydrocarbon Income Law (Ley de Ingresos Sobre Hidrocarburos) (HI Law).
- The Law for the Mexican Stabilisation and Development Oil Fund (Ley del Fondo Mexicano del Petróleo para la Estabilización y el Desarrollo) (Oil Fund Law).
- Amendment to the Federal Law of Budget and Fiscal Responsibility (Ley Federal de Presupuesto y Responsabilidad Hacendaria).

The Energy Bill is still being debated in the Federal Congress. Although it is likely that changes will be made as a result of the current discussions, their extent is still unknown. At the time of writing, the expectation is that the Energy Bill will be finally debated and approved by the end of June 2014, with formal publication in early July 2014.

Given this uncertainty, a high-level summary of the Energy Bill’s scope and purpose and its general framework is provided.

**CHANGES TO THE OIL AND GAS SECTOR PROPOSED BY THE ENERGY BILL**

The Hydrocarbon Law specifies what activities are considered part of the hydrocarbon industry:

- Superficial recognition and exploration, and hydrocarbon exploration and extraction.
- Treatment, refining, conveyance, commercialisation, transport and storage of petroleum.
- Processing, compression, liquefaction, de-compression and regasification, as well as the transport, storage, distribution and wholesale of natural gas.
- Transportation, storage, distribution and wholesale of liquefied petroleum gas.
- Transportation, storage, distribution and wholesale of products derived from petroleum.
- Transportation through pipeline and storage associated with pipelines of products derived from petrochemicals.

The exploration and production of hydrocarbons will be performed by the Mexican state through contractors, Pemex, or SPCs under the terms of the exploration and production contracts and the government concessions awarded. All other activities will be performed by private parties, Pemex or an SPC through permits, authorisations and contracts revealing that the purpose of the Hydrocarbon Law is to regulate upstream, midstream and downstream activities.

Another important proposal is the lifting of restrictions in the FIL, including participation by foreign investors in companies that engage in:

- Interior and cabotage navigation. This restriction no longer applies when the navigation provides a service to regulated activities of the hydrocarbon industry.
- International navigation. This restriction no longer applies when the purpose of the navigation is to provide services to hydrocarbons exploration and extraction activities.
- Drilling oil and gas wells.

A review of the reforms is set out specifically relating to:

- Upstream activities:
  - mineral ownership and granting instruments;
  - bidding rounds;
  - tax issues and financial obligations.
- Midstream and downstream activities:
  - permits;
  - pricing and tariffs;
  - natural gas;
  - open access;
  - integration;
  - fuel wholesale market.

**Upstream**

Mineral ownership and granting instruments. Ownership of hydrocarbons in the subsoil, including those located in the continental shelf and in the Mexican economic exclusive zone, remains with the Mexican state. Private parties holding an exploration and production “instrument” can report, for financial
purposes, the corresponding granting instrument and the expected benefits from it, provided the instrument confirms that the hydrocarbons in the subsoil remains the property of the state. The Mexican state is responsible for entering into oil and gas exploration and production activities. The activities can be performed by Pemex (or by any other SPC) or through private investors. Consequently, the state will grant Pemex, SPCs and private investors exploration and production instruments. These instruments can be either:

- **Government concessions (asignaciones).** Government concessions will only be granted by the Mexican state to Pemex or any other SPC. While it can directly award to either of these entities, the Mexican state must justify that the grant is in the best interests of the state. The fact that a government concession is granted in a specific block suggests that the block will not be open for a bidding round and other companies will not be able to engage in exploration and production activities in that block. Pemex and SPC holders of government concessions will not be allowed to enter into association type agreements with private investors, such as joint operating agreements and joint development agreements. However, they can enter into service contracts with private parties. Compensation to the contractors under these contracts must be in cash. A government concession will grant Pemex or the SPC the right to explore and produce hydrocarbons. Pemex (or the SPC) will pay the Mexican Government, as consideration, the amount set out in the HI Law, paid in the form of taxes.

- **Exploration and production contracts.** Exploration and production contracts are classified into four types that share general contracting provisions but contain different fiscal and economic terms:
  - licences;
  - production sharing contracts;
  - profit sharing contracts;
  - services contracts.

Exploration and production contracts will be awarded by the Mexican state through the National Hydrocarbon Commission, which will execute the contracts with private investors, Pemex or SPCs. The exploration and production agreements will be awarded through public bid procedures.

Holders of a government concession will be able to request to the Ministry of Energy (MoE) that the instrument be converted into an exploration and production contract. If authorised, the holder of the government concession (now an exploration and production contract), can enter with private parties into association agreements, such as a joint operating agreement. However, potential partners will be selected by the National Hydrocarbon Commission through a public bid procedure. If Pemex or the SPC are awarded an exploration and production contract, they will be allowed to enter with private investors into any kind of association agreement without the need to select the potential partner through a public bid procedure. The applicable law governing the association contract will be private law.

Depending on the specific exploration and production project, the Mexican state may include the right of the state to participate in the project through Pemex, an SPC or any other special purpose vehicle of the Mexican state. The circumstances in which the state can include this participation right are as follows:

- The subject matter of the contract block bid co-exists at different depths with a government concession block (state participation will not exceed 30% of the investment of the project).
- There are opportunities to boost knowledge and technology transfer to Pemex’s or any other SPC’s benefit (state participation will not exceed 30% of the investment of the project).
- A project is being promoted through a special purpose vehicle of the state.

The MoE will force the participation of Pemex or any other production entity of the state in projects where it is possible to discover a cross-border hydrocarbon field. In this case, state participation will be at least 20% of the amount of the investment for the project.

**Bidding rounds.** Exploration and production contracts will be awarded through public bid procedures. The request for proposals (RFPs) for the bid will be published in the Federal Official Gazette and the specific process of the bid will be governed by the guidelines issued by the MoE and the National Hydrocarbon Commission. Participants will need to meet the pre-qualification criteria in the guidelines. The award of the bid must be published in the Federal Official Gazette.

Participants can only challenge the award of the underlying exploration and extraction agreement through an indirect constitutional claim (amparo indirecto), brought before federal courts. The National Hydrocarbon Commission will not accept proposals or execute contracts with any entities that have:

- Been disqualified from executing agreements with the Federal Government.
- Defaulted in previous exploration and extraction agreements.
- Used third parties to avoid these restrictions.
- Submitted false information.

The National Hydrocarbon Commission will be able to directly award an exclusive exploration and production contract to mining concessionaires if the exploration and production contract is:

- To pursue exploration and extraction activities of coal-bed methane that is located at the mine operated by the concessionaire.
- A product of the mine.
- In respect of areas where the concessionaire is actually performing coal extraction activities.

The National Hydrocarbon Commission will execute the exploration and production contract if the mining concessionaire can evidence that it has the economic, technical, financial and administrative capability to perform the obligations under the exploration and production contract.

The National Hydrocarbon Commission, at the request of the Mexican Oil Fund, can hire Pemex, an SPC or a private party, through a public bid procedure, to commercialise the hydrocarbons obtained by the state as a consequence of the exploration and production contract.

**Tax issues and financial obligations.** Tax issues and financial obligations arise in licences, profit and production sharing contracts and service contracts:

- **Licences.** Licences will involve two financial obligations:
  - payment from the licensor to the state. This involves payment to the Mexican Petroleum Fund of a sign-in bonus; contractual fee during the exploration phase (based on a fixed amount per square kilometre of the area that is not under production, and which is increased from month 61 of the agreement; to incentivise exploration and production or...
relinquishment; royalties which differ for each type of hydrocarbon and the contractual value. Royalties are to be adjusted per PPI variations:

- the contractual value of oil is 5% if the price per barrel is lower than US$60 and a progressive formula when the price per barrel equals or exceeds US$60;
- the contractual value of natural gas depends on whether it is associated or non-associated gas;
- the contractual value of condensate is the same royalty as oil.

In addition, a fee is payable equal to a percentage of either the operating profit or contractual value of the hydrocarbons, which will be adjusted based on a mechanism set out in the corresponding contract. The operating profit will be determined based on the contractual value of hydrocarbons, less royalties and costs and expenses incurred, and a portion of investments made. Deductions of investments on exploration and infrastructure for the production and transport will be based on a special schedule (different to the schedule applicable for income tax purposes). Several expenses are considered non-deductible.

The contractual value of hydrocarbons is the market price of the hydrocarbons adjusted per quality, sulfur, API, and commercialisation, transport and logistics costs, among others;

- compensation to the contractor. The contractor will receive as compensation the hydrocarbons produced at wellhead, once it has paid the above amounts.

• Profit and production sharing contracts. These involve:
  - payments to the state. These are paid to the Mexican Petroleum Fund and include a contractual fee during the exploration phase (based on a fixed amount per square kilometre of the area that is not under production, and which is increased from month 61 of the agreement to incentivise exploration and production or relinquishment); royalties which differ for each type of hydrocarbon and the contractual value (see above, Licences); a fee equal to a percentage of the operating profit (to be adjusted pursuant to the contract. Operating profit is calculated as the contractual value of hydrocarbons less royalties paid and cost recovery.
  - compensation to the contractor. This involves the following payment by the Mexican Petroleum Fund in respect of:
    - cost recovery, subject to a percentage of the contractual value of hydrocarbons, and based on guidelines to be issued by the MoF. Costs do not include expenses that are non-deductible;
    - the remainder of the operating profit.

• Service contracts. Compensation will be paid to a contractor only in cash, not in kind.

Other features of exploration and production projects under the Hydrocarbon Law and the HL Law include provisions relating to:

- National content.
- Spills and environmental liability.
- Eminent domain and compulsory purchase.
- Social impact and mitigation.
- Decommissioning.
- Superficial recognition and exploration.

Midstream and downstream

Permits. Midstream and downstream activities are not considered strategic under the Hydrocarbon Law and these activities can be carried out by Penex, SPCs or private parties through a permit or authorisation. Midstream and downstream activities include the following:

- Treatment, refining, conveyance, commercialisation, transport and storage of petroleum.
- Processing, compression, liquefaction, de-compression and regasification, as well as the transport, storage, distribution and wholesale of natural gas.
- Transportation, storage, distribution and wholesale of liquefied petroleum gas.
- Transportation, storage, distribution and wholesale of products derived from petroleum.
- Transportation through pipeline, and storage associated with pipelines of products derived from petrochemicals.

The permits required for the above will be issued by either the:

- MoE. The MoE will issue permits for the:
  - treatment and refining of petroleum, natural gas processing and export and import of hydrocarbons, liquefied petroleum gas, petrochemicals and petroleum by-products;
  - transportation and storage activities that are not associated with pipelines of liquefied petroleum gas, as well as its distribution and wholesale.

- CRE. The CRE will issue permits for the:
  - transportation, storage, distribution, compression, liquefaction, decompression, regasification and wholesale of hydrocarbons, petroleum by-products and petrochemicals;
  - transportation through pipeline and storage associated with pipelines of liquefied petroleum gas. The energy regulatory commission will issue general regulatory provisions for the permits, which will include service terms and conditions as well as tariffs.

The activities included in a permit are considered of public interest. The Government will be able to temporarily occupy the assets, rights and facilities under the circumstances set out in the Expropriation Law, or when the permit holder breaches its obligations due to causes such as war, natural disaster, material alteration of the public order, or when the Government considers an imminent danger exists to national security, energy security or the national economy. Temporary occupation must not exceed 36 months.

Similarly, if the permit holder breaches its obligations under the permit, and the breach jeopardises the supply of hydrocarbons, liquefied petroleum gas, petroleum by-products or petrochemicals associated with the underlying permit, the MoE or the CRE will take over the assets and infrastructure of the permit holder so that the supply continues uninterrupted. For such purposes, the authority can use the personnel of the permit holder, impose a new operator or use a combination of both. A takeover is these circumstances must not exceed 36 months.

Parties wishing to engage in the commercialisation of hydrocarbons, liquefied petroleum gas, petroleum by-products and petrochemicals will not require a permit, however, they will need to register with the CRE, furnish the information required by the CRE and abide by its guidelines.

The CRE will also regulate matters associated with:

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• Tariff regulation.
• Shared infrastructure.
• Open access to infrastructure.
• Integration.
• Fuel wholesale markets.

**Tariff regulation.** The CRE will issue regulations associated with prices and tariffs for specific activities which will apply, unless effective competition conditions as declared by the Federal Economic Competition Commission. Similarly, in dealing with regulation of prices, CRE must obtain the opinions of the MoF and the MoE.

In the event that effective competition conditions do not exist in the diesel and petrol wholesale market, regulation of prices and maximum tariffs will be set by the "Executive", most likely, through CRE.

**Shared infrastructure.** The National Integrated Natural Gas Transport and Storage System (System) is composed of the:

- Transportation pipelines and storage facilities.
- Compression, liquefaction, decompression, regasification and other facilities associated with natural gas transport.
- Storage infrastructure.

It is clear from the Hydrocarbons Law that the System will be composed of the National Pipeline System of Petemex Gas y Petroquímica Básica (PGPB), the subsidiary of Petemex currently engaged in downstream natural gas activities, which is currently the largest pipeline system in Mexico. The idea is for such system to be transferred to the National Centre for the Control of Natural Gas (Cenagas), since the entity will be the independent operator of the System. Not only will PGPB be transferred to CENAGAS, but also the infrastructure owned by the companies in which PGPB has a majority stake. CENAGAS will provide transport and storage services through the infrastructure it owns.

The purpose of CENAGAS is to guarantee the continuity and security of Mexico's supply of natural gas. CENAGAS will operate as a permit holder that engages in transportation and storage activities, and will also operate the System pursuant to the operation rules to be issued by CRE. Since CENAGAS will be the market operator and a participant in the market through its provision of transportation and storage services, CENAGAS will be prevented from granting privileges to its infrastructure to the detriment of the infrastructure of other permit holders.

**Open access to infrastructure.** Permit holder engaging in the storage, transportation by pipeline and distribution by pipeline of hydrocarbons, liquefied petroleum gas, petroleum by-products and petrochemicals must grant open access to their facilities and services. Open access must not be unduly discriminatory, and will be subject to the available capacity in the underlying system pursuant to the regulations issued by CRE. Reserved but unused capacity in storage, distribution or transportation systems may be used by third parties, subject to payment of the corresponding tariff and to the regulations issued by the CRE.

Permit holders of transportation by pipeline and storage systems, subject to an open access obligation, will not be able to commercialise or sell hydrocarbons, liquefied petroleum gas, petroleum by-products and petrochemicals that have been transported or stored in their systems, except when commercialisation or sale is necessary to resolve an operational emergency, force majeure or act of God.

Similarly, permit holders of transportation and storage services will be subject to the following obligations:

- They may only provide the corresponding service to the users that evidence ownership of the product or to the persons appointed by them.
- They may only transport and store products of their property when it is necessary for the operation of its systems.
- In the case of liquefied petroleum gas, petroleum by-products and petrochemicals, they may transport their own products in the percentage allowed by CRE, included in the corresponding permit.

Holders of unused natural gas capacity in storage and transportation systems may commercialise it in secondary capacity markets, or make it available to the permit holder, who will be obliged to make the spare capacity public. In the event third parties are interested in this capacity, an open season procedure will be initiated.

Permit holders and users may enter into investment agreements to develop natural gas storage and transportation pipelines, as authorised by CRE.

**Integration.** Natural gas commercialisation companies may, directly or indirectly, participate up to 3% in the capital stock of natural gas pipeline transportation companies and associated storage companies. However, direct or indirect ownership of 10% of the capital stock of a natural gas commercialisation company will prevent a person from participating in the capital stock of a pipeline transport company or an associated storage company.

**Fuel wholesale market.** Fuel destined for aircraft will not be sold directly to the public. Its distribution will be controlled by authorised suppliers (Airport Law and Regulations).

Transportation, storage, distribution, sale and supply of hydrocarbons, liquefied petroleum gas, petroleum by-products and petrochemicals will be performed according to the provisions in the Hydrocarbon Law and applicable provisions.

Quality and measurement standards of the hydrocarbons, liquefied petroleum gas and petroleum by-products will be in accordance with official Mexican standards to be issued by CRE.

Diesel and petrol wholesale permits will be granted to private parties from 1 January 2017. Full competition with brands other than Petemex will also be possible starting in 2020.

**CHANGES TO THE POWER SECTOR PROPOSED BY THE ENERGY BILL**

The generation of power will no longer be considered a public service and the participation of private parties in this field will no longer be restricted.

The electricity industry includes the activities of generation, transmission, distribution, commercialisation of electricity, as well as the planning and control of the national electricity system (Electricity Law). The planning and control of the national electricity system and the public service of transmission and distribution are strategic areas. The Mexican state will engage directly in these activities. However, it will be able to enter into agreements with private parties who can participate in these activities as contractors.

In view of the changes to market structure, the Federal Government will be under a duty to promote the electrification of rural and marginal urban zones (Electricity Law). A universal service fund will be created to finance these actions.

The principle areas where changes will take effect are set out as follows.

**Transmission and distribution services.** Transmission and distribution services will be provided by the Mexican state, through CFE or SPCs and regulated by CRE. Tariffs will also be regulated.

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As mentioned, the state can enter into any type of agreement with private parties for the provision of these services.

CENACE will be the market operator of the national electricity system responsible for the National Electricity Grid in respect of:

- **Access.**
- **Balancing.**
- **Satisfying demand**
- **Ensuring reliability.**

**Offtakers.** The Electricity Law divides offtakers into two types of user depending on consumption profile:

- **Qualified users.** Qualified users will be large industrial consumers able to actively participate in the electricity market.
- **Users of basic service.** Users of basic service will be residential and small commercial consumers.

The legislation provides that basic service users will still be served by the CFE. Qualified users will be entitled to acquire and sell electricity in the wholesale market.

Tariffs for the basic service will be regulated by the MoF. Electricity traded in the wholesale market by generators, traders and qualified users will not be regulated.

**Market operation and structure.** The Electricity Law foresees an electricity market where generators will either enter into long term power purchase agreements, that is bilateral trading or will sell its production in the spot market, where CFE, SPCs, qualified users, suppliers and traders may acquire the electricity, either for their own consumption or to resell it. The electricity market will operate pursuant to the rules to be issued by the CRE. The Electricity Law also includes a type of hedge for the price of electricity. The instrument is an "electricity hedging agreement" and is similar to a contract for difference.

Under the new market structure, the participants in the electricity market will comprise of:

- **Generators.** These are holders of generation permits issued by CRE, or holders of electricity market participant contracts with CENACE, whose purpose is to represent generation centrals in the wholesale market. Generators may be exempt from securing a generation permit if the installed capacity of the underlying power plant is less than 500 kWh.
- **Traders.** These are holders of electricity market participant contracts with CENACE, whose purpose is the performance of trading activities.
- **Distributors.** These are state productive entities, including the CFE, that provide electricity distribution services.
- **Suppliers.** These are providers of electricity supply services, which includes the representation of final users in the wholesale market, the acquisition of electricity, the sale and delivery of electricity and the invoicing and collection services to final users. Suppliers are divided into qualified suppliers for qualified users and basic service suppliers for residential and small commercial users.
- **Wheelers or transporters.** These are state productive entities (including the CFE) that provide electricity wheeling (transmission) services.
- **Qualified users.** These are final users registered with CRE that will acquire electricity as market participants or through qualified suppliers.
- **Final users.** These are individuals or entities who acquire directly or through suppliers, electricity for their own consumption.

The CENACE will calculate the prices of the transactions held in the wholesale market based on the offers received according to the market rules. Market participants (generators, traders and qualified users) will be able to engage in the following transactions:

- Sale and purchase of electricity.
- Sale and purchase of ancillary services.
- Sale and purchase of power.
- Sale and purchase of electricity or power through export or import procedures.
- Clean energy certificates.
- Other products required for the efficient operation of the national electricity system.

The market rules will establish the dispute resolution mechanism between the market participants.

Transmission, distribution, trading and provision of the raw materials for the electricity industry will be performed independently. Each of those activities will be legally separated from each other. In the same way, the basic supply service will be legally separated from the other types of commercial activities.

The Federal Competition Commission will set out the terms and conditions of separation, with the aim of fostering open access and efficient operation. Generators and traders who are part of the same corporate group must perform inter-company transactions in accordance with guidelines to be issued by CRE.

**Social impact.** The MoE will inform developers of electricity infrastructure about the presence of vulnerable social groups in the area where the project is to be pursued.

Developers must submit before the MoE, a social impact evaluation, which must include the identification, characterisation and assessment of the social impact derived from the underlying project, as well as the mitigating measures proposed.

**Renewable obligations.** The MoE will be entitled to establish obligations to acquire clean energy or emissions certificates. A clean energy certificate issued by CRE will evidence the production of renewable energy, and will be used to fulfil the renewable obligations requirements imposed on final users. An emissions certificate, also issued by CRE will be traded in the wholesale market and used to fulfill the renewable obligations imposed on electricity generation plants. Both certificates may be traded.

**Step in rights of the state.** If the operation may jeopardise the reliability, continuity and security of the electricity supply, the MoE will be entitled to request that a third party steps into the operation of the permit holder, with the purpose of operating the facilities and assets of the permit holder on a temporary basis. Similarly, in the event of a natural disaster, war or when the national economy, national security or the reliability and continuity of the electricity supply is in jeopardy, the Federal Government can take over the assets of the original permit holder. The Federal Government must justify its actions. Except in the case of war or international armed conflict, the Federal Government must indemnify the affected parties.

**Geothermal energy.** The Geothermal Law aims to gather all the regulations associated with the exploration and exploitation of geothermal resources in one legislative instrument. SPCs, the CFE and private parties will be able to engage in geothermal energy activities, and obtain a concession to produce geothermal energy.

Geothermal activity is divided into three stages:

- **Recognition.** Recognition activities will not require a permit, but only registration with the MoE. Recognition activities can be
performed for eight months. Two months prior to the expiration of the registration, the interested party must apply for an exploration permit. Exploration permits are granted for up to three years, and they can be extended once. Each permit will be granted for an area of up to 150 square kilometres.

- **Exploration.** Holders of an exploration permit will be able to apply for a production concession. The production concession will be granted for a term of 30 years, which can be extended. The concession will cover an area of the same size or larger to the one covered in the exploration permit.

- **Production.** The production concession grants the right to its holder to produce geothermal energy from the underlying area. In general, each concession grants the right to its holder to perform exploration and production activities, use the geothermal resource for the production of electricity and use geothermal waters in accordance with the terms of the concession.

Concessionaires must comply with, amongst others, the investment and work programme included in the concession and pay the prescribed royalties or duties.

Holders of geothermal concessions can ask the MoE to intervene in the acquisition of rights of way and easements. Opposition by landowners will be handled by eminent domain or compulsory purchase procedures. The MoE can bid geothermal concessions, in cases where the existing holder notifies the MoE of a reduction in its capacity to pursue the activities granted under the concession. Revoked or terminated concessions will also be subject to public bid procedures. Geothermal fields may be utilised.

PEMEX and CFE will become SPCs with the goal of generating value for their “shareholders”, that is, the Mexican state. As such, each entity will be vested with more budgetary autonomy and resemble a commercial company.

In both cases, officers’ compensation will be competitive, without the usual restrictions for public officers. A special contracting and procurement regime will be applied. General government procurement laws will not be applicable.

**Pemex.** Pemex’s purpose will be that of an integrated oil company, able to pursue its activities in Mexico and abroad as follows:

- **Board of directors.** Pemex will be managed by a board of directors and CEO. The board of directors will be composed of ten members. It will be co-chaired by the Minister of Energy and Minister of Finance. Three members will be from the Government, five will be independent directors (a significant change, the oil workers union will no longer have a seat on Pemex’s board). Directors will not be subject to the regular liability regime of public officers. They will only be liable under the terms of the Pemex Law. In general, directors will be liable for the damages and lost profits caused by Pemex or any subsidiary due to their actions or omissions, including breach of their due diligence and loyalty obligations.

The board of directors will have the following committees:
- auditing;
- human resources and compensation;
- strategy and investment.

- **CEO.** The CEO will be appointed by the President. The President and the board of directors will be entitled to remove the CEO at any time.

- **Subsidiaries.** Pemex will be able to create subsidiaries to better pursue its corporate purpose, as well as to provide legal, financial and operational feasibility to a specific business. Subsidiaries may take the form of an SPC or a regular subsidiary.

SPCs may be awarded with government concessions and exploration and production contracts. SPCs are defined as entities that:
- perform oil and gas exploration and production activities under the terms of a government concession or an exploration and production contract;
- perform activities associated with the petroleum by-products obtained from its refining or processing;
- do not perform activities that assist or support the main activities of Pemex or with the purpose of being a vehicle to close a specific business.

Regular subsidiaries of Pemex will be defined as entities:
- in which Pemex holds, directly or indirectly, more than 50% equity, whether they are incorporated under Mexican or foreign law;
- prevented from engaging in the activities reserved to SPCs;
- not considered government entities that are organised in accordance with private law.

The activities of the SPCs and the regular subsidiaries must be aligned with Pemex’s business plan. Pemex’s board of directors will issue the policies related to Pemex’s participation in the equity of other legal entities with a minority stake. Pemex will not need the authorisation of any agency to acquire this minority interest.

- **Compensation.** The compensation of Pemex personnel will be based on the national and international market. The idea is to encourage a skilled workforce that will allow Pemex to pursue its corporate purpose. The compensation structure may include bonuses and other incentives.

- **Procurement.** All leases, acquisitions, services and works to be contracted by Pemex or the SPCs will be based on Article 134 of the Federal Constitution, that is, it must be completed through a public bid procedure. Such contracting procedures will ensure the best terms for the state with regards to price, quality, financing, opportunity and other circumstances associated with the underlying contract. If the public bid procedure does not ensure such terms, a different contracting procedure to be formulated by Pemex’s board of directors will apply. This contracting procedure may be a direct award or a restricted invitation to a number of participants. In order for such a procedure to apply, an exception to the public bid principle found in the Pemex Law must exist.

The award of the bid can be challenged, either through an administrative appeal or through a jurisdictional procedure held at the Federal Court of Tax and Administrative Justice. Participants in public bid procedures cannot submit challenges during the contracting procedure. Challenges can only be submitted against the final award. Once the underlying contract is signed, any dispute arising will be submitted to the federal judicial courts, unless an alternative dispute resolution mechanism has been agreed on.

Any contracting procedure of Pemex and the SPC will be governed by the Pemex Law, and not the alternative federal government procurement provision.

Pemex’s board of directors will issue the contracting guidelines to be used by Pemex and the SPCs.

- **Liability.** Pemex personnel will be subject to the general regime of liability imposed on public officers. In addition, they will be liable for the damages and lost profits caused by Pemex or the SPC due to their actions or omissions. However, liability will not apply in cases where the damages and lost profits were the result of a good faith business judgment, for example when the authorisation requirements for the underlying issue were
fulfilled and the decision was taken relying on the best information available at the time.

The liability unit of Pemex will not initiate a liability procedure or impose a fine on Pemex personnel, in cases where the action or omission of an employee was:
- a single act in one year, based on his judgment, several options could be validly argued and the decision taken was based on a consideration of the evidence;
- remedied voluntarily, without a request from the liability unit;
- an obvious mistake.

- **State dividend.** Each year, Pemex and the SPCs will pay a state dividend to the Federal Government. The amount of the state dividend will be determined by the MoF based on the financial information and business forecast delivered by Pemex. This information will be delivered in July of each year.

- **Dispute resolution.** Pemex and the SPCs can agree to arbitration clauses pursuant to Mexican commercial law and international treaties. With regards to contracts with an element of international performance, Pemex and its SPCs can agree to include foreign law as the governing law of the underlying agreement, and submit any dispute to the jurisdiction of foreign courts in commercial matters.

- **Merger.** The Pemex Law provides for the merger of the current subsidiaries so that they become two SPCs:
  - Pemex Exploración y Producción is to merge with Pemex Gas y Petroquímica Básica;
  - Pemex Petroquímica is to merge with Pemex Refinación.

**CFE.** CFE's purpose will be that of a power company, whose main activities include the generation and commercialisation of electricity, able to pursue its activities in Mexico and abroad. Its corporate purpose will include the commercialisation of natural gas, coal and any other fuel as follows:

- **Board of directors and CEO.** CFE will be managed by a board of directors and CEO. The board of directors will be composed of ten members. It will be co-chaired by the Minister of Energy and Minister of Finance. Three members will be from the government, four will be independent directors and one will be appointed by the employees of CFE. Directors will not be subject to the regular liability regime of public officers. They will only be liable under the terms of the CFE Law. In general, directors will be liable for the damages and lost profits caused by CFE or any subsidiary as a result of their actions or omissions, including breach of their due diligence and loyalty obligations.

CFE's board of directors will have the same committees as Pemex and the CEO will be appointed by the President. The President and the board of directors will be entitled to remove the CEO at any time (see above).

- **Subsidiaries.** The CFE may create subsidiaries to better pursue its corporate purpose, as well as to provide legal, financial and operational feasibility to a specific business. Subsidiaries may take the form of an SPC or a regular subsidiary.

SPCs will:
- provide the public service of electricity transmission and distribution;
- perform the activities of generation and commercialisation of electricity;
- not perform activities that assist or support the main activities of CFE or with the purpose of being a vehicle to close a specific business;
- generate nuclear energy.

Regular subsidiaries of the CFE will:
- be entities in which the CFE holds, directly or indirectly, more than 50% equity, whether they are incorporated under Mexican or foreign law;
- not be permitted to engage in the activities reserved to an SPC;
- not be considered government entities and organised in accordance with private law.

The activities of the SPCs and the regular subsidiaries must be aligned with the CFE's business plan.

The CFE's board of directors will issue the policies related to the participation of the CFE in the equity of other legal entities with a minority stake. The CFE will not need the authorisation of any agency to acquire this minority interest.

- **Compensation.** Compensation of CFE personnel will be determined on the basis of the national and international market. The aim is to ensure a skilled workforce that will enable the CFE to pursue its corporate purpose. The compensation structure may include bonuses and other incentives.

- **Procurement.** All leases, acquisitions, services and works to be contracted by the CFE or the SPCs will be based on Article 134 of the Federal Constitution, that is, they will need to be completed through a public bidding procedure. The contracting procedures and the procedure for challenging an award are similar to those in respect of procurement (see above).

Any contracting procedure of the CFE and the SPCs will be governed by the CFE Law, and not by the alternative federal government procurement provision.

The CFE's board of directors will issue the contracting guidelines to be used by the CFE and the SPCs.

The sale and purchase of power performed in the wholesale market will not be subject to the public bid requirement.

- **Liability.** The liability of CFE personnel is on a similar basis as the liability of Pemex personnel (see above).

- **State dividend.** Each year, the CFE and the SPCs will pay a state dividend to the Federal Government (see above).

- **Dispute resolution.** See above.

**The Mexican Oil Fund for Stabilisation and Development (Oil Fund).** The Oil Fund will be created (Oil Fund Law). The purpose of the Oil Fund is to receive, manage and distribute the revenue derived from the government concessions and exploration and production contracts, except for the taxes generated from such activities.

The Oil Fund will be created as a public trust, the Bank of Mexico (Mexico's Central Bank), will be its trustee and the MoF will be the settlor.

The technical committee of the Oil Fund will be composed of:

- Three representatives of the state, the:
  - MoF (chair);
  - MoE;
  - Governor of the Bank of Mexico.

- Four independent members. The independent members will be appointed by the President, with the approval of two thirds of the Senate.

The Oil Fund’s revenue will be utilised as follows:

- Pay consideration to the contractors under the government concessions as well as exploration and production contracts.
• Distributed among the other funds created, the Stabilisation and Research and Development funds.
• Pay the Mexican Government for the audit services provided by the Superior Audit Office of Mexico.
• Maintain the oil revenue of the Mexican Government equivalent to 4.7% of the Gross National Product of Mexico.

Once these payments have been made, the remaining revenue will constitute the Fund Reserve, which will be used to generate long-term savings and invest in financial assets. The revenue in the Fund Reserve may be transferred to the Mexican state to cover budgetary expenses.

CONCLUSION

Mexico is at the crossroads of what may become the most significant chapter in its energy legal framework since the reforms of 1938 and 1960. The impact of the restructuring of regulatory policy has yet to be ascertained but is likely to see the most dramatic change in the market for over 70 years.

While the reforms were long overdue, until about two years ago, the idea of such a significant overhaul would have been considered absolutely impossible for at least a decade. Now the changes have taken place at the constitutional level and the implementing legislation will be enacted in just a few weeks.

A Herculean effort on the part of all participants in the market is needed to step up to the new reality created by this radical legal framework. This includes all the government agencies in the sector, Pemex, the CFE, IOCs, NOCs, service providers, suppliers, consultants, advisors and lawyers. Some commentators warn that without a very careful roadmap of this transitional phase there are risks of fallout, particularly the way in which Pemex and the CFE operate as they have been suddenly deprived of their status as state monopolies.

Huge investment opportunities are anticipated in the next couple of years. The jury is out on how well implemented and regulated this new era in Mexico's energy policy will be. However, with the energy demands of a growing economy and the urgent need for a very significant increase in GDP, there can be little room for mistakes or delays.
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Recent transactions. Representing Pemex in a JOA with Petrofac and a shareholders' agreement with Schlumberger for the first integral risk service agreement stemming from the energy reform of 2008.
Languages. Spanish, English, French
Professional associations/memberships. Secretary of Mexico Unido Contra la Delincuencia; Former President of the Harvard Club of Mexico; Member of the Association of International Petroleum Negotiators; Member of the IBA, ABA and the Mexican Bar Association.
Publications. Several articles on energy related matters in specialised publications.

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Non-professional qualifications. Law degree, Instituto Tecnológico Autónomo de México, 1994; Masters degree, Georgetown University Law School, 2005; Postgraduate diploma in Executive International Finance, Georgetown University Business School, 1995; Postgraduate diploma in Executive Finance, Universidad Iberoamericana, 2004.
Recent transactions
- Representing Pemex in a JOA with Petrofac and Schlumberger for the first integral risk service agreement stemming from the energy reform of 2008.
- Representing Statoil Hydro in various exploration and production related matters.
- Representing Mitsui in several water infrastructure projects.
- Representing Seadrill in the acquisition and financing of a deepwater exploration platform for Pemex and its later negotiation and execution of the relevant lease with Pemex.
- Legal advice to Pemex (on matters of Mexican law) in the design of exploration and production service agreement for the areas of Chicontepec and others.
- Representing Goldcorp in the negotiation of a long term PPA for a project in Mexico.
Languages. Spanish, English
Professional associations/memberships. Asociación Nacional de Abogados de Empresas; Association of International Petroleum Negotiators.

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Recent transactions

- Representing Pemex in a JOA with Petrofac and a shareholders’ agreement with Schlumberger for the first integral risk service agreement stemming from the energy reform of 2008.
- Representing Apache in the first round of first integral risk service agreement stemming from the energy reform of 2008.
- Representing Mitsui in several water infrastructure projects.
- Representing Seadrill in the acquisition and financing of a deepwater exploration rig for Pemex and its later negotiation and execution of the relevant lease with Pemex.
- Legal advice to Pemex (on matters of Mexican law) in the design of the exploration and production service agreement for the areas of Chicontepec and Deepwater COM.
- Representing Procter and Gamble in a long-term supply and transport natural gas agreement for one of its production sites in Mexico.
- Representing Goldcorp in the negotiation of a long term PPA for a project in Mexico.

Languages. Spanish, English

Professional associations/memberships. Asociación Nacional de Abogados de Empresas; Association of International Petroleum Negotiators.

Publications. Regulation of Marine Oil Spills in Mexico, 2010; Oil, Gas and Energy Intelligence, Regulation of Oil Spills and Blowouts under Mexican Law, 2011; Global Reference Guide; Energy and Utilities, Financier Worldwide. Co-authored with Carlos Ramos Miranda.