

CLIENT UPDATE

MEXICAN CONGRESS APPROVES AMENDMENTS TO ENERGY LAWS

On August 14, 2013, President Enrique Peña Nieto submitted to the Mexican Congress a proposal to amend the Mexican Federal Constitution (the “Constitution”) on energy matters. The proposal was approved by the Senate on December 11, 2013 and by the Chamber of Deputies on December 12, 2013. The proposal will now be subject to approval by a majority of local congresses in the states of Mexico.

The proposed reform’s objectives include allowing participation by Mexican and foreign companies in the exploration, drilling, refining, storage and distribution of oil and petrochemical products, so as to increase the volume of capital and the breadth of technology that can be utilized to bring Mexico’s oil industry to current international standards of development and efficiency. In addition, the proposed reform seeks to allow participation by Mexican and foreign companies in the generation, supply and distribution of electricity.

The following are highlights of the proposed amendments:

- The Mexican Government shall maintain ownership of oil and petrochemical products.
- The Mexican Government shall execute agreements with Mexican and foreign companies, so that such companies shall be entitled to undertake exploration and drilling of oil in Mexico.
- The Mexican Government shall grant permits to Mexican and foreign companies that will provide for refining, storage and distribution of oil and petrochemical products by such companies.
- Companies that execute contracts to conduct exploration and drilling activities, as well as companies that receive permits to provide refining, storage and distribution services, shall be subject to regulatory, supervisory, and enforcement requirements from Mexican Government agencies likely to include the Ministry of Energy, and the Energy Regulatory Commission.
- The Mexican Government shall execute agreements with Mexican and foreign companies for generation, supply and distribution of electricity by such companies.

Background

The Mexican Federal Constitution of 1917 establishes that oil and oil derivatives are owned by the Mexican State. The initial text of the Constitution permitted the granting of “concessions” by the Mexican Government so that Mexican and foreign companies could undertake exploration and drilling activities in Mexico.

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Facing opposition by foreign companies to comply with labor judgments rendered by Mexican courts, President Lazaro Cardenas introduced in 1938 a bill in Congress to amend the Constitution and terminate the regime of “concessions”. The Mexican President issued also a decree expropriating plants, machinery and equipment of oil companies, with payment of compensation.

The above-mentioned bill was passed by Congress and was enacted into law in 1940.

The constitutional amendments did not foreclose the possibility of the Mexican Government executing contracts for exploration and drilling of oil by private companies.

Petroleos Mexicanos (the Mexican state-owned oil company; “Pemex”) had some initial degree of success in managing Mexico’s oil industry during the first years of operations after the constitutional reform. This success was substantially related to the fact that Mexico’s initial reserves were located predominantly in areas of relatively easy access.

Such initial moderate success was one of the factors that led the Mexican Congress to adopt more stringent measures in 1958 and 1983, amending the Mexican Federal Constitution so as to foreclose the possibility of the Mexican Government executing contracts with private companies for the exploration and drilling of oil.

However, since that original success, exploitation of oil reserves found now require more intensive capital and use of new technology drilling. It has become evident that Pemex lacks the necessary resources to conduct such tasks. The Mexican Government has rightly decided not to allocate to Pemex’s operations public funds needed for education, health, security and other priority objectives.

The proposed amendments to the Constitution, if approved by a majority of state legislatures where a majority for approval of the same seems to exist, would pave the way for participation by both Mexican and foreign companies, so as to allow a full development of the potential of Mexico’s oil industry.

Agreements for Exploration and Drilling of Oil by Private Companies

The proposal seeks to enable the Mexican Government to execute agreements with Mexican and foreign companies, so that such companies shall undertake exploration and drilling of oil in Mexico.

Consideration for such agreements may include (i) payment in cash, (ii) profit sharing, (iii) production sharing, (iv) title to a percentage of oil once extracted, and (v) a combination of the above.

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Income from such agreements shall be transferred to a Mexican Oil Trust, that will utilize them primarily to support the Oil Income Stabilization Fund. The Mexican Government shall maintain ownership of oil and petrochemical products, as well as the power to regulate the oil industry.

Permits for Refining, Storage and Distribution by Private Companies

In a significant reassessment of Federal Government policy followed between 1940 and the present time, the proposal states that the Mexican Government shall grant permits to Mexican and foreign companies that will authorize the refining, storage and distribution of oil and petrochemical products by such companies.

Companies that execute contracts to conduct exploration and drilling activities, as well as companies that receive permits to provide refining, storage and distribution services, shall be subject to regulatory, supervisory, and enforcement requirements from Mexican Government agencies, likely to include the Ministry of Energy and the Energy Regulatory Commission.

Implementing Legislation

The proposed amendment to the Constitution will require the passage of implementing legislation. One hopes that such legislation will spell out clear, simple and transparent rules for both the execution of contracts to conduct exploration and drilling, and the granting of permits for refining, storage and distribution activities.

Parallel Measures

In parallel to the adoption of the proposed reform and the passage of implementing legislation, it will be of paramount importance to define clear rules that will seek to impose transparency, limits of operation and accountability in the Pemex union, traditionally a powerful and corrupt union in Mexico. This step will be critical for the success of the proposed reform.

Supply and Distribution of Electricity

The Mexican Congress amended the Constitution in 1960 so as to provide that the generation, supply and distribution of electricity should be conducted exclusively by the Mexican Government.

Limited steps to permit some degree of generation by private companies have been taken in the last few years. Meanwhile, supply and distribution have remained the domain of the Mexican Government, with a lack of capital and technology to develop the electricity industry at the pace required by Mexico's development.

In a substantial review of policy followed between 1960 and the present time, the proposal seeks to enable the Mexican Government to execute agreements with Mexican and foreign companies for generation, supply and distribution of electricity by such companies.

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The Mexican electricity system shall remain under the regulation and supervision of the Mexican Government.

As discussed in connection with the oil industry, it is hoped that implementing legislation will be clear, simple and transparent.

Likewise, it will be of paramount importance to define rules that will impose transparency, limits of operation and accountability in the Federal Electricity Commission union. Such Commission acts as Mexico's principal producer and distributor of electricity as of today.

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Once implementing legislation is passed by the Mexican Congress, we will circulate a more detailed memorandum. In the meantime, please do not hesitate to contact us with any questions.

Berdeja Abogados, S.C.

December 12, 2013