

# Implementation Energy Reform

## **Introduction**

On December 20, 2013, President Enrique Peña Nieto signed into law amendments to the Mexican Federal Constitution (the “Constitution”) on energy matters.

On April 30, 2014, President Enrique Peña Nieto submitted to the Mexican Congress a proposal to pass implementing legislation which consists of nine new statutes and amendments to twelve existing statutes.

This memorandum provides (1) general background information and a description of the process and legal requirements of the new market and (2) the key considerations relating to a process for private companies to participate in the market.

## **Background**

The oil industry in Mexico was nationalized in 1938, when the Mexican Government expropriated all assets and domestic oil fields operating in Mexico from international oil companies. Petróleos Mexicanos (the national oil company, “Pemex”) was established at the time, to own those assets and operate those fields, and was granted a monopoly on all oil activities by the Constitution. After some initial success, Pemex is considered today a grossly inefficient oil company. This can be explained, significantly, by the financial dependency of Pemex on the Government. The lack of fiscal autonomy has limited Pemex’s capacity to invest, leading its debts to increase in order to finance production expansion.

In 2003, Pemex created a new type of agreement, so called “multiple-services contract”, to allow private investors to participate in natural gas exploitation. Seeking to strengthen Pemex’s capacity to operate oil activities, an initial reform which facing political opposition fell short of what was needed, allowed Pemex greater freedom to contract work out to private companies, manage its own revenues and raise cash by issuing bonds that only Mexicans could buy.

The existing legal framework is to be replaced by a framework that will foster private participation and competition, seek transparency, and commit Mexico to a mandatory carbon-reduction regime.

Energy law is a federal matter under the Constitution.

The proposed implementing legislation would consist of seven principal statutes: I The Hydrocarbons Act, governing crude oil, petroleum and gas; II The Electricity Industry Act, regulating production, transmission and wholesale power sales of electric energy, and the

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review of public utility mergers and acquisitions and other public utility corporate transactions, III The Geothermal Power Act regulating geothermal energy; IV The Hydrocarbons Sector Environmental Protection and Industrial Safety National Agency Act, regulating environmental protection powers in the hydrocarbons sector, V The Petroleos Mexicanos Act, governing the national oil company; V The Federal Electricity Commission Act, governing the national electricity company, VI The Energy Regulatory Agencies Coordination Act, establishing the powers and coordination functions of regulators in the energy field; and VII The Development and Stabilization Mexican Oil Fund Act, setting up an oil revenues trust fund. As mentioned above, twelve additional existing statutes are proposed to be made subject to conforming amendments.

## **Oil and Gas**

The Constitution provides that oil and natural gas are owned by the Mexican State.

The proposed legislation redefines the role of Pemex. Under the proposed legislation, The Ministry of Energy may grant concessions to Pemex or other state-owned companies, for the exploration and production of oil and natural gas (also called “hydrocarbons” under the proposed statutory language).

The proposed legislation empowers the Mexican Government to execute agreements with Mexican and foreign companies, including Pemex, so that such companies may undertake exploration and production of oil and natural gas in Mexico.

Initial implementing legislation authorizes the Federal Government to grant to Pemex, without a bid, concessions to perform exploration and exploitation in some areas already subject to exploration and production under previous legislation. In a so called “round cero”, Pemex was allowed to request on December 20, 2013 that the Ministry of Energy grant concessions to the same in respect to a number of fields. We understand that Pemex requested concessions over approximately 30% of prospective resources in Mexico, the majority of which are placed on land and shallow waters. We further understand that such request includes 93% of Mexico’s prospective resources located in land; 59% of prospective resources located in shallow waters; 29% of prospective resources located in deep waters and 15% of prospective resources located in lutites. The review of Pemex’s request started on March 21, 2014. The Ministry has 180 days to decide, on the basis of Pemex’s capacity and operational planning, which of such fields can be so granted to Pemex. A determination is expected to be made by the Ministry on or before September 17, 2014. Pemex will be subsequently required to compete in bidding rounds with other companies, signing agreements for exploration and production with the Ministry of Energy if successful. Only in instances in which there is a need to secure future supply of hydrocarbons, can Pemex be awarded future concessions without a bid.

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A concession granted to Pemex can be replaced by the Ministry of Energy upon Pemex's request, by an agreement in which private companies may participate either as sole contractors or as members of a consortium in which Pemex participates. A bidding process is required to be conducted to select the companies that will participate in the agreement that will replace a previous concession. The circumstances that would permit a replacement are not included in the proposed bill and should be specified in the implementing legislation.

The execution of an agreement for exploration and production with a private company may require participation by Pemex in up to 30% of the interest in the agreement in instances where the area proposed to be covered by the agreement overlaps with the area of a concession granted to Pemex, or the project is a priority project sought to be financed by a Pemex-owned financial vehicle. This requirement applies to both, a new agreement or an agreement that would replace a concession granted to Pemex.

A mandatory 20% participation by Pemex is required in those instances in which an international field interconnected with parts of other countries is proposed to be drilled.

The proposed legislation requires as a general rule an open bidding process to select the company to which an agreement will be awarded, regardless of whether the process results in the award of an agreement to Pemex or to a private company. The process starts with an invitation to be published in the Official Daily of the Federation, a pre-qualification period, a period for questions and comments on the bidding bases, a period for bid submissions and a deadline for the granting of the award. The time-frame between publication of the invitation and submission of bids should take no less than 90 days.

The award can be contested by indirect amparo proceedings. The Mexican federal courts may exercise significant powers through the suit of amparo, which consists of a power to deny, on a case-by-case basis, the enforcement of actions taken by the legislative or the executive branch in violation of the Federal Constitution. The purpose of this type of suit is to protect (amparar) private persons whose individual Constitutional rights have been violated through laws or acts of governmental authorities. A direct amparo suit has the effect of staying a governmental order or award pending a decision by the relevant court. Participants challenging awards in bidding rounds will only be able to file indirect amparo suits, which do not have the effect of staying a governmental order or award, unless and until a final favorable court decision is rendered by the relevant court.

The beneficiaries of coal mining concessions (within the meaning of the Mining Act), whether state-owned grantees of coal mining concessions or private parties, are entitled to execution of an agreement for the drilling of additional wells and production of coalbed methane gas on the field of the coal mining concession, without a bidding process being required.

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The Ministry of Energy (i) selects areas to be made subject to agreements, (ii) drafts agreement forms, (iii) issues technical specifications, and (iv) approves the transfer of control or operations of a relevant contractor, among other powers.

Determination of the economic terms to be considered so as to award an agreement, is entrusted to the Ministry of Finance.

The National Hydrocarbons Commission (i) issues the bidding basis, (ii) administers the bidding process, (iii) executes the agreements, (iv) oversees technical matters related to oil and gas agreements, (v) oversees accounting and financial reporting required under the agreements, and (vi) oversees performance of obligations by concession beneficiaries, parties to agreements and other authorized parties.

The proposed legislation requires a minimum local content of 25% in oil and gas projects, to be met gradually by concession beneficiaries and parties to agreements. The meaning of “local content” is to be defined by the Ministry of Energy with the opinion of the Ministry of Economy. Subject to such determination, “local content” is likely to refer to the minimum percentage of costs of Mexican origin required for the total costs of a project. It is likely to be established in respect to each item of the subsystems of a project (for example, geology and geophysics, drilling, completion and evaluation, operational support, system production and collection of plant). The mechanism by which parties will gradually meet local content requirements in each project shall be specified in the bidding basis for such project.

There are three fundamental categories of activities within the Mexican Government’s powers which require authorization by means of a license or registration:

- The Ministry of Energy is entrusted to review and issue licenses for oil refining, processing of natural gas, exports and imports of oil and natural gas, LNG and oil derivatives, as well as transportation (other than by means of pipelines) and storage of LNG.
- The Energy Regulatory Commission is charged with the review and granting of licenses for the transportation, storage, distribution and sales to the public of oil, natural gas and oil derivatives, as well as the safe operation and reliability of proposed and operating transportation of LNG by pipeline facilities.
- Retail sales require registration with the Energy Regulatory Commission.

Licenses can be revoked upon occurrence of breaches of applicable regulations, among other causes.

Regulatory and enforcement powers are very significant. Specifically, proposed provisions mandate open access to the distribution system and grant the Energy Regulatory Commission discretionary authority to define manipulation by rule or order, prevent market power exercise,

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issue orders to seek open access to the distribution system and require dissemination of information that would improve transparency of wholesale markets.

Civil and criminal liabilities may be imposed. Applicable fines range from US\$78,000 to US\$38,725,000

Federal courts have exclusive jurisdiction over energy matters.

The land owner and the operator of a permitted oil or gas well may negotiate in accordance with pre-established basic rules which require advance written notification of construction activity by the operator to the land owner, to agree to terms for the use or purchase of required land. Should an agreement fail to be reached at a price not lower than market price within 90 days of negotiation, the operator may file a request for mediation proceedings to be administered by a governmental institution, the National Assets Appraisal and Administration Institute. Should mediation fail after the operator complies with required steps, such Institute may request the Ministry of Energy to petition the Executive for (i) establishment of an eminent domain taking of a right of way, or (ii) expropriation of the land.

The Energy Regulatory Commission is charged with regulation of wholesale markets of oil and gas derivatives, until the Federal Economic Competition Commission states that conditions for effective competition in the relevant markets in Mexico have been achieved.

### **Electricity**

The Constitution provides that transmission and distribution of electricity are to be conducted by the Mexican Government.

The proposed legislation provides that the Mexican Government may license Mexican and foreign companies to produce electricity, or to participate representing producers, as sales agents, in the electricity market. Producers will be permitted to sell electricity directly on the market.

It is envisaged that the Federal Electricity Commission (the national electricity company; Comisión Federal de Electricidad or “CFE”) shall continue supplying electricity to households, as well as to small and medium size industries. Qualified purchasers shall be able to purchase electricity directly in the market, whether from CFE or from independent producers. A “qualified purchaser” is in essence, an end user with consumption in excess of certain levels, registered with the Energy Regulatory Commission to purchase electricity as a participant in the market.

The old legal framework is to be replaced fundamentally by a legal framework that will foster private participation, open access to all participants and competition in Mexico’s electricity industry. The proposed legislation provides that the Ministry of Energy can impose disciplinary

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measures on a participant, including orders to divest specific assets or blocks of shares, or break the participant into different corporations, in those instances in which the participant has denied open access to other participants, breached its obligations or adopted transfer pricing practices among industry segments.

The Ministry of Energy is entrusted to define power policy, draft electricity wholesale supply agreement forms, define minimum national content requirements to be included in such agreements, establish the requirements of clean energy and clean emissions certificates, and interpret the Electricity Industry Act.

The Energy Regulatory Commission is charged to grant licenses for electricity production, regulate rates of producers, establish mechanisms for issuance and review of rules of operation in the market, draft connection and retail agreements, issue clean energy and clean emissions certificates, issue bidding basis to be followed by CENACE (a regulator to be discussed below) and rules of operation to be observed between production and distribution companies.

The National Center for Energy Control (“CENACE”) is empowered to issue and oversee compliance with rules of operation of Mexico’s electricity system, including rules applicable to production, transmission and distribution of electricity.

Under the proposed legislation, security interests can be created on rights derived from agreements relating to the electricity system. Public assets cannot be encumbered by security interests.

The proposed legislation sets forth the main criteria under which Mexican and foreign companies may participate in bidding processes to provide transmission and distribution services. Under the same, the Mexican Government would remain responsible for such services, with the joint liability of the companies to which a transmission and distribution project is awarded under a public bidding process.

A commercial activity is defined to comprise, among other, supply of electricity to end users and representation of power producers in the wholesale electricity market. The Energy Regulatory Commission is charged with assuring that electricity rates and practices shall be just and reasonable. The agency is empowered to determine the just and reasonable rate or practice and fix the same by order. The Commission is entrusted with the review and issue of licenses for suppliers. Supply agreements must be registered with the Consumer Protection Federal Agency.

The land owner and the operator of a permitted electricity facility may negotiate in accordance with pre-established basic rules which require advance written notification of construction activity by the operator to the land owner, to agree to terms for the use or purchase of required land. Should an agreement fail to be reached at a price not lower than market price within 60

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days of negotiation, the operator may file a request for mediation proceedings to be administered by the National Assets Appraisal and Administration Institute. Should mediation fail after the operator complies with required steps, such Institute may request the Ministry of Energy to petition the Executive for (i) establishment of an eminent domain taking of a right of way, or (ii) expropriation of the land.

CENACE is charged with implementing a change from a scheme that controlled market power exercise by utilities, pipelines and producers through classic monopoly rate regulation to a regulatory regime that controls the exercise of market power through reliance on a mixture of competition and regulation so as to seek to achieve just and reasonable rates.

Regulatory and enforcement powers are very significant. Specifically, proposed provisions mandate open access to the production, transmission and distribution system and grant the Ministry of Energy discretionary authority to define manipulation by rule or order, prevent market power exercise, issue orders to seek open access to the relevant system and require dissemination of information that would improve transparency of wholesale markets. The Ministry of Energy is empowered to order the annulment of transactions carried out in breach of such rules and instruct CENACE to effect retroactive refunds. In addition to the power to impose civil liabilities, the Ministry of Energy must report conduct that may violate the Federal Competition Act to the Federal Competition Commission, for the latter regulator to investigate such practices and impose applicable sanctions.

The proposed legislation establishes the basis to foster the production and consumption of electricity produced from renewable sources in response to concerns over energy independence, climate change and the disappearance of fossil fuels. Such basis requires an electric utility, electric provider and designated consumers to produce or purchase a specified percentage of electricity from renewable energy sources. Implementing measures will include clean energy certificates (“CECs”), among others. CECs will be issued by the Energy Regulatory Commission for sale in the wholesale market, to allow a producer or retail electricity provider to produce or purchase a specified percentage of electricity from renewable energy sources. CECs are instruments representing the environmental attributes of renewable energy that may be traded separately from the energy itself. Electricity suppliers may comply with the proposed legislation by (i) owning a renewable energy facility (with a designated capacity) and its production, (ii) purchasing CECs, or (iii) purchasing electricity and the accompanying renewable attributes from a renewable energy facility. The Ministry of Energy will further specify the rules for the issuance of such certificates.

The proposed legislation entrusts CENACE with the approval of the National Energy Commission, to conduct open bidding processes to purchase electricity in the wholesale market.

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The National Energy Commission shall issue basis to regulate rates applicable to (i) transmission, (ii) distribution, (iii) CENACE services, and (iv) other significant services required in the wholesale electricity market. The National Energy Commission is charged with promoting competition and innovation when structuring such basis. To this end, the Commission is allowed to authorize utilities to charge market-based rates for wholesale power sales, in addition to cost-of service-rates. The policy embodied in the proposed implementing legislation is intended to create competitive pressures that would improve efficiency, reduce costs, and lower wholesale power prices.

Regulators have discretionary power to require dissemination of information that would improve transparency of wholesale markets.

Of special significance are the enforcement provisions of the proposed implementing legislation, including the authority to impose civil penalties that range from US\$52,000 to US\$259,000 per violation. Certain violations may be fined with an amount equal to three times the price of the electricity consumed within a given period or 10% of total sales of a company during the preceding year.

### **Restructuring of National Oil and Power Companies**

The proposed implementing legislation seeks to redefine the roles of Pemex and the CFE. In essence, both companies are envisaged to migrate from a model in which they were established to own and operate a monopoly, to companies that will be entrusted with a significant role in the development of the oil and power industries, but will need to compete with private companies in bidding rounds in a number of areas, signing agreements with the Mexican Government, if successful.

#### **Pemex**

Motivated by the reasons outlined in the Background section above, including the gross inefficiency of Pemex as concurrently structured, the proposed implementing legislation seeks to restructure Pemex and convert it into a “productive state corporation”. In essence, a state-owned corporation in which the role of the Mexican Government will be similar to that of a shareholder and will not consist of managing Pemex. Pemex will be granted planning, fiscal and operational autonomy to conduct its activities.

Under existing legislation, Pemex is charged with exploration and production of oil, gas and related products. It is also authorized to process, transport, distribute and sell the same. Under the proposed legislation, Pemex will continue being allowed to undertake such activities and under a significant change, will be authorized to do so directly or through agreements executed with private parties. As mentioned before, Pemex will be granted a first priority right to



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request that a number of fields in which production is currently undertaken be granted in concession to Pemex by the Ministry of Energy.

Pemex will be required to conduct open bidding processes to execute agreements with private companies to conduct activities in fields awarded to Pemex under concessions or agreements. Restricted bidding processes or direct awards are permitted in certain instances.

The proposed legislation authorizes Pemex to grant security in connection with its activities, provided title to oil and gas that have not been drilled yet remains the property of the Mexican Government.

The board of directors of Pemex is to be comprised of ten members, five of which are government officials appointed by the Executive and five of which are independent members, which may not hold another government position, appointed also by the Executive. Independent directors serve three-year terms and have an equal vote. It would be desirable to limit the number of independent members that can belong to the same political party, so as to increase the prospects of independence and diversity in such directors.

Pemex's board shall have audit, strategy and investments, and human resources committees. The audit committee shall be comprised of three independent directors. The other two committees will be chaired by independent directors. The board may establish other committees.

Directors can be held accountable for damages arising from breach of statutory duties, including due diligence and loyalty, among others. A civil action to claim damages may be initiated by Pemex before federal courts. An action based upon the proposed legislation could not be initiated by a private party. The proposed legislation should be revised so as to specifically provide that the imposition of responsibilities under the same does not preclude the imposition of responsibilities applicable under other statutes.

Pemex may incorporate subsidiaries and participate in affiliates, with prior board approval. Subsidiaries' activities shall consist fundamentally of exploration and production of oil and the same may not participate in ancillary activities or special-purpose projects. Pemex may participate in affiliates in which it holds 50% or more of capital stock. The board may authorize investments by affiliates in other corporations, provided certain requirements are complied with.

The board of directors is entrusted, among others, with (i) issuing open bidding basis, (ii) issuing requirements applicable to other methods to award agreements in case of exceptions permitted under proposed legislation, (iii) assure the transparency of bidding processes, (iv) disseminate information relating to award and execution of agreements, (v) establishing requirements for minimum national content.

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An award can be contested by a plea for reconsideration or by a legal action before the Administrative and Tax Federal Court. An action can be initiated by a party in interest (such as a competing bidder), on the grounds of violations of applicable legal provisions or the bidding basis in the process.

The proposed implementing legislation requires the board to periodically and systematically make public disclosure of Pemex's financial, operational and legal information, in compliance with the requirements of article 104 of the Securities Exchange Act. The proposed provision states that "relevant events" must be communicated to the board. It is advisable to revise the proposed implementing legislation and expressly state that such events must be forthwith disclosed to the public as well, in order to ensure transparency in the market.

Pemex is subject to Mexican federal courts. It may submit to foreign law and to the jurisdiction of foreign courts in transactions that have effects outside of Mexico. It may also submit to arbitration.

### **Federal Electricity Commission**

The CFE was established in 1938, to own assets destined to power production and was granted a monopoly on all power activities by the Constitution.

Following a method similar to that of Pemex, proposed implementing legislation seeks to restructure CFE and convert it into a "productive state corporation". CFE will be granted planning, fiscal and operational autonomy to conduct its activities, subject to the controls of the Public Debt Act.

Under existing legislation, CFE is authorized to produce, transfer, distribute and supply electricity. Under the proposed legislation, CFE will continue being allowed to undertake such activities and under a significant change, will be authorized to do so directly or through agreements executed with private parties.

CFE will be required to conduct open bidding processes to execute agreements with private companies to conduct activities relating to such utilities. Restricted bidding processes or direct awards are permitted in certain instances.

The proposed legislation authorizes CFE to grant security in connection with its activities, subject to prior board approval.

The board of directors of CFE is to be comprised of ten members, five of which are government officials appointed by the Executive and five of which are independent members, which may not hold another government position, appointed also by the Executive. Independent directors serve three-year terms and have an equal vote. As mentioned in respect to Pemex, it would be desirable to limit the number of independent members that can belong

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to the same political party so as to increase the prospects of independence and diversity in such directors.

CFE's board shall have audit, strategy and investments, and human resources committees. The audit committee shall be comprised of three independent directors. The other two committees will be chaired by independent directors. The board may establish other committees.

Directors can be held accountable for damages arising from breach of statutory duties, including due diligence and loyalty, among others. A civil action to claim damages may be initiated by CFE before federal courts. An action based upon the proposed legislation could not be initiated by a private party. The proposed legislation should be revised so as to specifically provide that the imposition of responsibilities under the same does not preclude the imposition of responsibilities applicable under other statutes.

CFE may incorporate subsidiaries and participate in affiliates, with prior board approval. Subsidiaries' activities shall consist fundamentally of production, transmission, distribution and supply of electricity, and the same may not participate in ancillary activities or special-purpose projects. CFE may participate in affiliates in which it holds 50% or more of capital stock. The board may authorize investments by affiliates in other corporations, provided certain requirements of applicable law are complied with.

The board of directors is entrusted, among others, with (i) issuing of open bidding basis, (ii) issuing requirements applicable to other methods to award agreements in case of exceptions permitted under proposed legislation, (iii) assure the transparency of bidding processes, (iv) disseminate information relating to award and execution of agreements, (v) defining cost elements on the basis of which CFE shall participate as a bidder in bidding processes, (vi) issue its internal regulations, and (vii) approve joint ventures in which CFE, its subsidiaries or affiliates propose to participate.

An award can be contested by a plea for reconsideration or by a legal action before the Administrative and Tax Federal Court. An action can be initiated by a party in interest (such as a competing bidder), on the grounds of violations of applicable legal provisions or the bidding basis in the process.

The proposed implementing legislation requires the board to periodically and systematically make public disclosure of CFE's financial, operational and legal information, in compliance with the requirements of article 104 of the Securities Exchange Act. The proposed provision states that "relevant events" must be communicated to the board. It is advisable to revise the proposed implementing legislation and expressly state that such events must be forthwith disclosed to the public as well, in order to ensure transparency in the market.

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CFE is subject to Mexican federal courts. It may submit to foreign law and to the jurisdiction of foreign courts in transactions that have effects outside of Mexico. It may also submit to arbitration.

## **Mexican Oil Fund**

A Mexican oil trust fund is proposed to be created. The trustee of the fund will be Banco de México (Mexico's Central Bank). Revenue from petroleum activities should go straight to the fund. The fund shall also receive other income arising from hydrocarbon-related activities.

The fund shall make payments due under concessions and exploration and production agreements. Surplus wealth above what is required to make such payments shall be utilized (i) to fund stabilization and research funds, (ii) up to 4.7% of GDP for the previous year, to be utilized each year in the annual budget, (iii) in investments with the aim of achieving as high a return as possible within a moderate risk, (iv) once the fund's assets exceed 3% of GDP, Congress may decide to allocate excess funds to be utilized in the annual budget.

The managing committee of the fund is to be comprised of seven members, three of which are government officials appointed by the Executive and four of which are independent members, which may not hold another government position, appointed by the Executive with the consent of the Senate. As discussed in the context of Pemex and the CFE, it would be desirable to limit the number of independent members that can belong to the same political party, so as to increase the prospects of independence and diversity in such members.

The proposed implementing legislation requires the managing committee to periodically and systematically make public disclosure of the fund's financial, operational and legal information.

The auditor of Banco de México shall be also the auditor of the fund.

Committee members can be held accountable for damages caused to the Treasury in terms of federal statutes, arising from breach of duties. The conduct proscribed under the proposed legislation must be intentional in order to give rise to civil liability. Damages must be proven. An action to claim damages may be initiated by CFE before federal courts.

The objective of keeping in the fund a minimum of 3% of GDP is tepid. The Norwegian Government Pension Fund Global had at the end of 2013 a market value equal to 140% of Norway's GDP. Given the need to save for Mexican future generations, the minimum target of the proposed reserve should be substantially increased to a meaningful percentage of GDP. The fund's guidelines should not allow local investments. It would be extremely important to insulate the fund from economic fluctuations in Mexico. All spending of the return of capital invested must be approved by Congress as part of the balancing of the government budget. Any route from fund to consumption other than through the government budget should be expressly ruled out. The fund regulations should protect the domestic economy from

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overspending of oil revenue, as well as avoid making the fund a source of cheap money for political purposes. It is desirable for Banco de México to create a separate unit within the Bank to manage the fund, so as to attain the specialization and concentration required to manage the fund within the objectives of investment appreciation and adequate risk management.

## **Renewable Energy**

Mexico is committed to a climate change policy that is both, environmental policy and energy policy.

Climate change involves critical decisions such as the future level of Mexico's electricity supply, the future price of electricity, and the future supply mix of Mexico, which is to say, the extent to which Mexico should rely on coal, nuclear, natural gas, and renewable energy to meet future electricity supply needs.

Existing legislation charges de Ministry of Energy with issuing the rules pursuant to which private parties and some state-owned corporations shall be entitled to obtain licenses to develop renewable energy sources for public power production. Such sources include, among other, wind, solar, geothermal, waste utilization and hydrokinetics projects.

Such legislation entrusts the Energy Regulatory Commission with the task to issue licenses, among other, for hydrokinetics projects and execute the agreements relating to the same. Hydrokinetics is the use of waves, tides, and currents from oceans and free-flowing rivers to generate electricity. The potential for these technologies in Mexico is enormous.

## **Federal Regulators**

The proposed implementing legislation creates a new regulator, the Hydrocarbons Sector Environmental Protection and Industrial Safety National Agency. In a nutshell, the Agency will focus on oil and gas safety and related environmental protection. Among other functions, the Agency will approve the siting and abandonment of oil and gas pipelines and storage facilities, the siting for processing projects under limited circumstances, the safe operation and reliability of proposed and operating LNG terminals, will foster development of mandatory carbon capture and sequestration technologies, will oversee environmental matters related to natural gas and oil projects and other matters, and enforce its regulatory requirements through imposition of civil penalties and other means.

Considering the convergence between certain regulated areas, the proposed legislation establishes rules and procedures so that regulators including the National Hydrocarbons Commission, the Energy Regulatory Commission and the Hydrocarbons Sector Environmental Protection and Industrial Safety National Agency coordinate investigations and market oversight.

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## **Private Equity and Financial-Sector Firms**

Market convergence and the circumstances created by the proposed legislation are likely to be reflected in the entry of private funds and financial-sector firms in energy markets. The role of the financial sector in wholesale power and natural gas markets is likely to make such sector a significant market participant.

The need of electricity and natural gas companies to raise capital to fund operations and necessary infrastructure development is likely to foster the participation of private funds and financial-sector firms in wholesale power and gas trading and marketing.

Another form of entry by private funds and the financial sector in the energy industry, will be the passive ownership of energy company securities. Investment firms will have the opportunity to purchase significant ownership interests in energy companies, particularly power companies. This is an area of significant opportunities for private funds and financial-sector firms.

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Please do not hesitate to contact us with any questions.

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