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COMMENTARY

Mexico's New Regulatory Framework for Oil and Gas: Transportation, Refining, Environmental, and Tax

The following is the third chapter in a four-part Commentary *discussing the groundbreaking reforms to Mexico's oil and gas sector. The* Commentary *chapters are as follows:*

Part I - Mexico's New Regulatory Framework for Oil and Gas
Part II - Private Investment in Mexican Natural Resources
Part III - Transportation, Refining, Environmental, and Tax
Part IV - What's Next for Mexico?

Transportation

Under the new hydrocarbons legislation, the *Comisión Reguladora de Energìa* ("CRE," the National Energy Regulatory Commission of Mexico) will have jurisdiction over the transportation, storage, distribution, compression, liquefaction, and decompression of hydrocarbons, petroleum resources, petrochemicals, and gas.

The package also establishes the National Center for the Control of Natural Gas (*Centro Nacional de Control del Gas Natural*—"CENAGAS"), with the aim of guaranteeing the continuity and security of the country's natural-gas supply, as well as the integration of that supply into Mexico's national pipeline network. This agency will replace Pemex and Federal Electricity Commission (*Comisión Federal de Electrical*—"CFE") in existing contracts for gas transportation, thereby reducing the participation of those two entities in the pipeline sector and opening areas of opportunity to private parties.

Refining, Processing, and Marketing of Oil, Gas, and Petrochemicals

The downstream sector in Mexico is also undergoing a dramatic change. In the past, only *Petroleos Mexicanos* ("Pemex") was allowed to carry out downstream activities, but under the new legislation, any entity will be allowed to obtain a permit from the Ministry of Energy to engage in refining, the manufacture and processing of petrochemicals, and other downstream activities. Permits may also be obtained for the export and import of hydrocarbons, liquefied petroleum gas, petroleum resources, and petrochemicals.

Ministry of Energy permission is not required for the sale of hydrocarbons, liquefied petroleum gas, petroleum resources, or petrochemicals, including gasoline and diesel fuel. Nevertheless, prices will be regulated by the Ministry of Finance and Public Credit (*Secretaría de Hacienda y Crédito Público*—"SHCP") through 2020.

Companies that are already engaged in the transportation, storage, distribution, and sale to the public of oil, gas, and petrochemicals on the date the legislation took effect, but that did not have permission from the CRE or the Ministry of Energy, may continue their activities, provided that they request and obtain provisional permission within three months of that date. This permission will be valid for one year.

The Hydrocarbons Law includes a transition period for price deregulation, which will extend until January 10, 2020. For the remainder of 2014, the maximum prices for unleaded gasoline, premium gasoline, and diesel fuel in Mexico will continue to be controlled through a directive issued by the federal government. From January 1, 2015, to December 31, 2017, the maximum prices will be adjusted by the Federal Executive. From and after January 1, 2018, prices for gasoline, diesel, and premium gasoline in Mexico will be determined by the market.

Another significant change is the role that private entities will soon play in the distribution and sale of gasoline. Permission to sell gasoline and diesel fuel to the public may be granted by the CRE after January 1, 2016. This represents a significant change to the sector, since service stations and other activities for the sale of gasoline, diesel, and other petrochemicals to the public were previously a monopoly of Pemex.

Until December 31, 2016, permission to import gasoline and diesel fuel will be granted only to Pemex. Beginning on January 1, 2017, however, permission may be granted to anyone capable of fulfilling the requirements established by the Hydrocarbons Law.

Environmental Protection

From an environmental protection perspective, the biggest development from the reform package is the creation of the Law of the National Agency for Industrial Safety and the Protection of the Environment of the Hydrocarbon Sector (*Agencia Nacional de Seguridad Industrial y de Protección al Medio Ambiente del Sector Hidrocarburos*—"ANSIPASH"). The ANSIPASH is a decentralized entity of the Ministry of the Environment and Natural Resources, which will act in coordination with the Ministry of Labor and Social Welfare, the Ministry of the Navy, the Ministry of Energy, and the Ministry of the Interior. In essence, the ANSIPASH has been designed to be a management entity, as well as one that inspects and oversees the sector.

The ANSIPASH will be in charge of developing standards and regulations applicable to the hydrocarbon sector that pertain to industrial and operational safety and the protection of the environment. Once it establishes those standards and regulations, the ANSIPASH will advise other government entities regarding the technical aspects of industrial and operational safety and environmental protection that will apply. It will also issue authorizations, permits, and licenses concerning environmental matters for the hydrocarbons sector.

The ANSIPASH will also have compliance and enforcement duties. It will oversee the industry's fulfillment of industrial and operational safety and environmental protection standards, and, where necessary, it will require corrective, emergency, and safety measures. It will also have the authority to impose administrative penalties for noncompliance, including fines, the suspension or revocation of permits, and the decommissioning of facilities. While the Ministry of the Environment already had the ability to levy the same types of fines and penalties, the new laws significantly increase the amounts of those penalties, which will be based on Mexican minimum wage rates and will vary from 7,500 days of minimum wage (roughly US$38,821.15) up to 7.5 million days of minimum wage (approximately US$38,821,153.85). The dollar amounts will vary depending on the value of minimum wage at the time the penalties are assessed and the current exchange rate.

In addition to creating the ANSIPASH, the secondary laws contemplate the creation of "clean energy certificates" to promote the use of renewable energy and other clean technologies. If established, the certificates would be granted to certain generators that produce energy from "clean" resources, or acquired by suppliers, qualified users, and end-users in wholesale electricity markets. The law does not establish specific requirements for the clean energy certificate program, or exactly how it would operate, so creation and implementation of the program will require additional legislation.

It should be noted that the transitory articles of the constitutional amendments of December 20, 2013 contemplate even broader changes to Mexico's environmental legal framework, including specific modifications to existing environmental laws and the creation of emissions reduction certificates, which were not addressed in the secondary measures. This additional environmental reform is expected to be presented to Mexico's Congress during the legislative period of September–December, 2014.

Tax

The "tax package" of the secondary laws (which is made up primarily of the Hydrocarbon Revenues Law) regulates the following:

- The general tax rules applicable to compensation to the government payable under agreements covered by the Hydrocarbons Law (for tax purposes, the compensation does not qualify as a "contribution," and the businesses or entities that provide the service will be subject to the general tax scheme established by the Income Tax Law);
- The fees that signees will pay to the government for projects that are directly assigned to them (as above, for tax purposes, the government fees do qualify as contributions); and
- Certain tax rules that are specific to oil and gas projects, such as special depreciation rules or permanent establishment rules.

Lawyer Contacts

For additional information about the reforms in Mexico, or for previous installments of this commentary, please contact your principal Firm representative or one of the lawyers listed below. General email messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com.

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