



Initiative for Laws Regulating the Energy Reform Presented Before the Federal Congress

On April 30, 2014, the Mexican President, Enrique Peña Nieto, submitted to the Mexican Congress legislation that, if approved, will implement the historic constitutional energy reform that became effective in December 2013. This new legislation consists of nine new laws and amendments to 12 other laws, which were filed in nine packages:

Hydrocarbons

The hydrocarbons package includes the creation of the Hydrocarbons Law, as well as amendments to the Law of Foreign Investment, the Mining Law, and the Law of Public-Private Partnerships.

In conformity with the constitutional amendments made on December 20, 2013, the Mexican nation maintains ownership of all petroleum and all solid, liquid, and gaseous hydrocarbons located underground. Petroleum exploration and extraction shall be carried out by means of assignments to wholly owned state entities (*Empresas Productivas del Estado* – Productive State Enterprises) or agreements awarded to private entities.

The initiative establishes the National Hydrocarbon Commission (*Comisión Nacional de Hidrocarburos* –

CNH), which shall maintain geophysical and geological information; award exploration and extraction agreements; and support the Ministry of Energy (*Secretaría de Energía* – SENER) in the granting of assignments to the Mexican state-owned petroleum company, Mexican Petroleums (*Petróleos Mexicanos* – PEMEX). The CNH shall also administer and supervise assignment and agreement fulfillment and dictate plans for exploration and extraction.

The package will also establish the National Center of Natural Gas Control (*Centro Nacional de Control del Gas Natural* – CENEGAS), with the aim of guaranteeing the continuity and security of the country's natural-gas supply.

In addition, the initiative allows foreigners to invest in shipping companies dedicated to intra-coastal navigation as well as international shipping, as long as their activities support hydrocarbon exploration and extraction.

Foreign investment is also permitted in the commercialization of gasoline; the distribution of liquefied petroleum gas; the supply of fuels and lubricants for vessels, aircraft, and rail locomotives; the construction of pipelines for the transportation of crude oil and its

byproducts; domestic ground-transportation activities for the hydrocarbon industry; and the drilling of oil and gas wells.

Exploration and Extraction (Upstream)

Petroleum exploration and extraction shall be carried out through assignments to Productive State Enterprises or agreements awarded to private entities.

Assignments

The SENER, subject to the ruling of the CNH, may grant assignments to PEMEX for hydrocarbon exploration and extraction.

On March 24, PEMEX requested assignments for specific oil reserves. On September 17, the SENER, advised by the CNH, shall determine which reserves shall be assigned to PEMEX during “Round Zero” (*“Ronda Cero”*) and which shall be awarded through a competitive bidding process.

It should be mentioned that the initiative does consider the possibility that PEMEX will transfer assignments to exploration and extraction agreements. In such a case, the CNH shall determine, through a public bidding process, who will be PEMEX’s associate.

Agreements

The transitory articles of the constitutional amendment establish that the exploration and extraction agreements may be: (i) license agreements; (ii) service agreements; (iii) profit-sharing agreements; (iv) production-sharing agreements; or (v) any combination of these. However, the Hydrocarbons Law refers only to agreements of exploration and extraction in general, and it is the Hydrocarbons Revenues Law that contains the distinctions between the contracting schemes.

According to the initiative, the CNH may enter into exploration and extraction agreements with PEMEX or with private entities through public bids.

PEMEX may also participate in the bids for exploration and extraction agreements through alliances or associations with private entities. In cases of cross-border reserves, PEMEX participation of at least 20 percent shall be obligatory.

The Hydrocarbons Law introduces the concept of a “legal easement for hydrocarbons” (*servidumbre legal de hidrocarburos*), which includes the right of way, free transit, transportation, handling, and storage of materials and machinery for the construction, installation, and maintenance of infrastructure, as well as the carrying out of projects and works covered by the assignment or agreement for superficial exploration.

Compensation, along with the terms and conditions for the acquisition, use, enjoyment, or easement of the property necessary for hydrocarbon exploration and extraction, shall be negotiated among the holders of said goods and the signees or contractors. In the event that no agreement between the parties exists, the signee or contractor may:

- a) Promote the enactment of the legal easement for hydrocarbons before the relevant district judge; or
- b) Request mediation by the Institute of Administration and Appraisal of National Goods (*Instituto de Administración y Avalúos de Bienes Nacionales – INDAABIN*). The INDAABIN shall call upon two experts to perform an appraisal. In the event that the difference between the two experts’ appraisals ends up being less than 15 percent, the simple average of the appraisals shall be taken. If the difference between the appraisals amounts to 15 percent or more, a third expert shall be selected, and the average of the three appraisals shall be taken. If the parties do not accept the compensation proposed by the INDAABIN, the dispute will be submitted before the SENER, who will propose to the President the enactment of a legal easement or the expropriation of the property.

Transport (Midstream)

The hydrocarbons package requires permission from the Regulatory Commission of Energy (*Comisión Reguladora de Energía – CRE*) for the transportation, storage, distribution, compression, liquefaction, and decompression of hydrocarbons, petroleum resources, petrochemicals, and gas.

Additionally, it includes the legal easement for hydrocarbons for the construction of pipelines to transport gas, crude oil, and its derivatives.

Refining and Processing of Gas and Petrochemicals (Downstream)

The SENER's permission is required for the treatment and refining of petroleum; the processing of natural gas; and the export and import of hydrocarbons, liquefied petroleum gas, petroleum resources, and petrochemicals.

Commercialization and Selling to the Public

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

Those who, on the date that the initiative comes into effect, engage in the transport, storage, distribution, and public selling of these commodities without the corresponding permission of the CRE or the SENER may continue carrying out said activities, provided that they request and obtain provisional permission within the three-month period following the initiative's coming into effect. This permission shall be valid for one year.

The transitory articles of the Hydrocarbons Law include a transition period for price deregulation, which will extend until January 10, 2020. During 2014, the maximum prices for unleaded gasoline, premium gasoline, and diesel fuel will increase by 9, 11, and 11 cents, respectively, per month. From January 1, 2015, to December 31, 2019, the maximum prices shall be adjusted monthly by the SHCP.

Permission for selling gasoline and diesel fuel to the public may be granted by the CRE after January 1, 2017. After this date, PEMEX may not subject the supply of gasoline and diesel fuel to the condition of entering into franchise agreements.

Until December 31, 2018, permission to import gasoline and diesel fuel shall be granted only to PEMEX. On and after January 1, 2019, permission may be granted to anyone capable of fulfilling the requirements established by the Hydrocarbons Law.

Electricity

The electrical amendment package includes the creation of the Electric Industry Law. In conformity with the constitutional amendment, planning and control of the national electricity system, as well as the transmission and distribution of electricity as a public service, will continue to be governed by the state, but the electrical energy generation sector will be opened up to private investment.

The initiative seeks to create competition and to lower prices within the sector, as well as to drive the transition to clean energy. This measure is part of Mexico's effort to comply with the country's commitment to generate 35 percent of its electricity by means of renewable sources by 2024.

The National Center of Energy Control (*Centro Nacional de Control de Energía – CENACE*) will become a decentralized public entity of the Federal Public Administration in charge of programming the national electricity system, including the planning and control, as well as the operation, of the wholesale electricity market. Transmission and distribution will remain the responsibility of the Federal Electricity Commission (*Comisión Federal de Electricidad – CFE*).

Additionally, the package defines "Qualified Users," who can buy electricity from generators, as well as "Traders," who would operate within the wholesale electricity market.

It should be mentioned that a legal easement has also been created for the development of electrical-industry activities and that the occupation or superficial easement of the necessary property for the development of said activity is considered to be of public utility.

Finally, the package provides for the creation of pollution emission and clean-energy certificates, the operation of which shall be legislated in supplementary provisions.

Geothermal Energy

The geothermal energy package sets forth the enactment of the Geothermal Energy Law, as well as amendments to the National Waters Law. This initiative seeks to develop Mexico's geothermal potential by creating a legal framework that regulates the exploration for and use of geothermal reserves in accordance with environmental principles.

The initiative defines the concept of "geothermal water," separating it from the general provisions applicable to the national waters. In cases involving hydrothermal reserves, the SENER shall turn the file over to the National Water Commission. In turn, the commission shall issue the concession for the use of geothermal water, which must be re-injected into the geothermal region, with the aim of maintaining the reserve's sustainability.

It should be mentioned that geothermal reserves are considered to be of preferential public utility with regard to any other subsoil use (with the exception of that of hydrocarbons), for which the temporary occupation, easement, or expropriation of the necessary property for the development of said activity shall proceed. Similarly, the law considers the rights regarding subproducts that might be discovered in the course of exploring for and extracting geothermal resources to be preferential, as well as the framework to transfer the rights and obligations contained in the respective deeds.

The National Agency for Industrial Safety and the Protection of the Environment of the Hydrocarbon Sector

This package provides for 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 shall 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.

The ANSIPASH shall be in charge of developing standards and regulations applicable to the hydrocarbon sector that pertain to industrial and operative safety and the protection of the environment. It shall issue authorizations, permits, and licenses concerning environmental matters applicable to that sector, overseeing compliance and imposing appropriate penalties. The ANSIPASH has been conceived as an entity of management, as well as one of inspection and exclusive oversight for the sector.

Coordinated Regulatory Energy Entities

This package establishes the Law of the Coordinated Regulatory Energy Entities, as well as amendments to the Law of the Federal Public Administration.

The Law of the Coordinated Regulatory Energy Entities will regulate the organic elements of the CNH and the CRE, while the Hydrocarbons Law, the Electric Industry Law, and the Geothermal Energy Law will establish the obligations, powers, and attributes of the CNH and the CRE.

The Coordinated Regulatory Energy Entities shall have technical, operative, and management autonomy, as well as financial autonomy derived from the collection of government fees and charges. They shall have a governing body made up of seven commissioners assigned by the Mexican Senate, each of whom will be selected from a triad proposed by the President.

The Energy Coordinating Council will also be created, comprising the head of the SENER, the presidents of the CNH and the CRE, and the general directors of CENEGAS and CENACE.

Productive State Enterprises

The package for Productive State Enterprises will enact a new *Petróleos Mexicanos* Law and the Federal Electricity Commission Law, as well as amendments to the Federal Law of Semi-Public Entities; the Law of Acquisitions, Leasing, and Public-Sector Services; and the Law of Public Works and Related Services.

The objective of the initiative is to create Productive State Enterprises of an entrepreneurial nature, governed by commercial laws, and to homologate the provisions for the publicity of information with the provisions of the Stock Exchange Law, even when these enterprises are not listed on the stock exchange.

This initiative establishes that PEMEX shall be administered by a board of administration made up of five government advisors (among whom shall be the heads of the SENER and the SHCP) and five independent advisors.

Similarly, the package proposes to restructure PEMEX as a holding company with two subsidiaries: a primary-production subsidiary (responsible for gas processing, exploration, and extraction) and an industrial-transformation subsidiary (responsible for refining and petrochemicals).

In turn, the CFE will be administered by a board of administration made up of five government advisors (among whom shall be the heads of the SENER and the SHCP), one advisor from the union, and four independent advisors.

Likewise, the restructuring of the CFE as a holding company with several subsidiaries has been proposed, with one transmission subsidiary, one or more generation subsidiaries, and eight subsidiaries in charge of distribution.

Fiscal

The “fiscal package” of the secondary laws (which is made up primarily of the Hydrocarbon Revenues Law) regulates the following: (i) the general rules applicable to the compensation that shall be paid in the agreements covered in the Hydrocarbons Law (for fiscal purposes, the compensation amounts do not qualify as contributions, and the businesses or entities which provide the service shall be subject to the general fiscal scheme established in the Income Tax Law); (ii) the government fees that the signees shall pay for the projects which might be directly assigned to them (for fiscal purposes, the government fees do qualify as contributions); and (iii) certain fiscal rules that are specific to these projects, such as special depreciation rules or hypotheticals for the generation of a permanent establishment.

Budget

The budget package includes amendments to the Federal Law of Budgeting and Financial Responsibility and the General Law of Public Debt, with the aim of adjusting the existing legal framework to the modifications proposed in the amendment; in general terms, this package deals with the handling of petroleum revenue, the transformation of the CFE and PEMEX into Productive State Enterprises, and the new budget and debt scheme proposed for said enterprises.

In accordance with the proposed amendments to the General Law of Public Debt, direct or contingent liability obligations derived from financial credits granted to Productive State Enterprises are considered public debt.

Nevertheless, Productive State Enterprises shall be in charge of the management and handling of their obligations. Once a year, each such enterprise shall send its global funding proposal to the SHCP so that it might be incorporated into a specific paragraph of the initiative of the Law of Revenue of the Federation, to be submitted before the Federal Congress.

Similarly, Productive State Enterprises may negotiate and execute funding agreements without the authorization of the SHCP. The board of administration of each of the Productive State Enterprises will rule on the general terms and conditions of said obligations.

It should be mentioned that said obligations do not constitute obligations guaranteed by the Mexican government, and they may not be guaranteed with the hydrocarbons located underground or with shares of Productive State Enterprises or their subsidiaries.

The Mexican Petroleum Fund for Stabilization and Development

The enactment of the Law of the Mexican Petroleum Fund for Stabilization and Development has been proposed as a means of receiving and administering resources derived from exploration and extraction assignments and agreements, with the aim of improving long-term savings and the management of resources driving investment in the hydrocarbon sector.

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