



Mexico has recently begun a sweeping and historic reform to its energy industry.

In December 2013, President Enrique Peña Nieto launched the reform of Mexico's energy sector through a constitutional amendment that opened the oil and gas industry, and the power generation sector, to private participation. The significance of the change can not be overstated because prior to that time the Mexican energy industry was for most purposes not open to foreign investment.

On August 12, 2014, Mexico adopted nine new "secondary laws" as well as amendments to existing laws which implement the December 2013 constitutional changes.

With respect to Mexico's oil and gas industry, the changes are being made in order to increase Mexico's diminishing production of hydrocarbons. Despite an increase in investment by Mexico in exploration and extraction, oil production in Mexico declined from 3.4 million barrels per day in 2004 to 2.5 million in 2012, with consequent negative effects on the Mexican economy.

By making these changes, Mexico hopes to kick-start its production of oil and gas by attracting significant outside investment for the first time since foreign oil companies were ousted in 1938.

Legal Structure

Under the constitutional amendments, Mexico will retain direct dominion over the subsoil as well as the exclusive right of exploitation and development of petroleum and gas. The Constitution still prohibits the private ownership of hydrocarbons and reserves ownership of all solid, liquid, and gaseous hydrocarbons, to the Mexican state. Also, the Mexican federal government will keep ownership and control of *Petróleos Mexicanos* ("Pemex").

However, for the first time, the production of hydrocarbons in Mexico will be carried out through allotments (*asignaciones*) granted to Pemex or other Productive State Entities ("PSE") or through the execution of exploration and extraction contracts with the private sector.

Private oil companies will be able to book the contracts for exploration and extraction as their reserves and report the reserves with the understanding that the hydrocarbons in the subsoil are the property of the Mexican government.

Pemex will be able to execute joint ventures and partnerships with private sector companies, and also enter into contracts for exploration and extraction.

The Law on Public-Private Partnerships was amended to allow public-private partnerships in activities such as refining, natural gas processing, transportation, distribution and storage of hydrocarbons, liquefied petroleum gas, shale gas, and oil.

Private sector companies will be able to participate in downstream activities.

Compensation to the private sector shall include (a) cash for service contracts; (b) a percentage of income for profit sharing contracts; (c) a percentage of the production obtained for production sharing contracts; (d) the transfer of hydrocarbons once they have been extracted from the subsoil for license agreements; or (e) any combination of the above.

Bidding Process

During a process known as Round Zero, announced on August 13, 2014, Pemex was provided with a portfolio of assets to exploit on its own or through joint ventures with international oil companies. The Ministry of Energy ("SENER"), with the technical assistance of the National Hydrocarbons Commission, was in charge of implementing Round Zero.

In 2014 Mexico also launched the first round of bidding for oil and gas rights in which private companies can participate ("Round One"). The first phase features 14 shallow-water areas. Any Mexican, foreign or state productive company may participate in the bidding round either individually or in consortium.

To qualify as an operator, a company must have served from 2010 to 2014 as operator for at least three exploration and production projects ("E&P") or have total aggregate capital E&P investments of at least \$1 billion. The company must also show experience as an operator in at least one offshore E&P project or as a partner in at least two such projects and must show experience in industrial safety and environmental protection within the last five years.

Government Agencies

There are many government agencies that will be responsible for overseeing the energy reform, including the following:

- *Ministry of Energy (Secretaria de Energia, SENER)*. SENER will continue to establish energy policy. It will also decide which fields will be open for exploration and production by private companies, determine technical and financial requirements for bidders, and determine which contract types will be awarded.
- *National Hydrocarbons Commission (Comision Nacional de Hidrocarburos, CNH)*. This commission focus on the upstream sector. It will oversee regulation; run public tenders according to the rules established by SENER and SHCP; oversee the bidding process; name the winning bidder of the each tender; and oversee seismic and geological studies.
- *Energy Regulatory Commission (Comision Reguladora de Energia, CRE)*. CRE will regulate the electricity, midstream, and downstream sectors.
- *Ministry of Environment and Natural Resources (Secretaria de Medio Ambiente y Recursos Naturales, SEMARNAT)*. This agency is responsible for protecting, conserving, and restoring the natural resources, assets, and environmental services of Mexico.
- *National Agency for Industrial Safety and Environmental Protection (Agencia Nacional de Seguridad y Proteccion al Medio Ambiente*



del Sector Hidrocarburos, ANSIPA). It will regulate and oversee environmental and safety issues, and operate under SEMARNAT.

- *Ministry of Finance and Public Credit (Secretaria de Hacienda y Credito Publico, SHCP)*. SHCP will bear primary responsibility for deciding or negotiating fiscal terms for each contract type and designing the Mexican Petroleum Fund for Stabilization and Development (Fondo Mexicano del Petroleo para La Estabilizacion y el Desarrollo). This will be a sovereign wealth fund with primary responsibility for the national oil income.
- *National Center for Natural Gas Control (Centro Nacional de Control de Gas Natural, CENEGAS)*. It will operate the state-owned natural gas pipelines and storage facilities.
- *National Center for Energy Control (Centro Nacional de Control de Energia, CENACE)*. It will operate the state-owned electricity grid.

Secondary Laws

The nine new secondary laws are as follows:

- *Hydrocarbons Law*. Grants the government the ability to contract the exploration and production of hydrocarbon resources to any state production company or private entity.
- *Hydrocarbons Revenue Law*. Enables the state to execute certain agreements with private enterprises for hydrocarbon exploration and extraction, namely: licensing agreements, profit sharing agreements, production sharing agreements, and service agreements.
- *Pemex Law*. Transforms Pemex into a State Productive Company and calls for merging the company's exploration and production arm with its gas and petrochemicals business with the intent of creating a more competitive corporate structure. This law also grants Pemex the ability to partner with third parties. As a State Productive Company, Pemex is obligated to meet the requirements of various new government entities.
- *Law of the Mexican Oil Stabilization and Development Fund*. The Mexican oil fund will receive, manage, and distribute revenue derived from the exploration and exploitation of hydrocarbons resulting from agreements entered into by the state with third parties or by direct awards granted by Pemex.
- *Power Industry Law*. Repeals the Law of the Federal Public Service of Electric Energy which regulated the power industry since 1975. This law creates the possibility of trading electric power with third parties, although power transmission and distribution remain under the control of the national power grid.
- *Federal Electricity Commission Law*. Transforms the Federal Electricity Commission (CFE) into a State Productive Company and establishes guidelines regulating acquisitions, leases, services and works, budget, and debt.
- *Law of Coordinated Energy Regulatory Agencies*. Grants the National Hydrocarbons Commission (CNH) and Energy Regulatory Commission (CRE) their own legal standing as well as technical, procedural, and

budgetary autonomy. This law is intended to improve technical oversight of the energy industry.

- *Geothermal Energy Law*. Allows private parties to carry out the inspection, exploration, and exploitation of geothermal resources to generate power.
- *Law of the National Agency of Industrial Safety and Environmental Protection of the Hydrocarbons Sector*. Creates an agency under the Ministry of Environment and Natural Resources (SEMARNAT) with technical and procedural autonomy. This agency is tasked with regulating and supervising industrial and operational safety as well as environmental protection.

Conclusion

Mexico is just starting to implement a process by which it hopes to attract significant foreign capital for essentially all areas of its energy sector, including up stream oil and gas exploration and production, refineries, pipelines, electrical generation, supply chain and related activities.

The energy reform presents a valuable opportunity both for Mexico and for foreign investors as the process unfolds over the next several years and decades.

At this point in time, with decades of experience and investment in energy by the private sector the U.S., there is significant opportunity for U.S. companies to become involved.

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