

INSIGHTS

Mexican President Submits Legislation to Congress for Implementation of Constitutional Energy Reforms

May 7, 2014

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Following the historic constitutional energy reforms passed by the Mexican Congress in December 2013, Mexican President Enrique Peña Nieto submitted on April 30, 2014 for the consideration and approval of the Mexican Congress the secondary legislation (the "Legislation") that will implement these reforms, overhauling the Mexican oil and natural gas, petrochemical, and power generation industries. Committees of the Senate and House will now study the Legislation with final passage expected by the end of June. The Legislation includes nine new laws and amendments to several current laws. **Oil and Gas Reform** The cornerstone of the Mexican energy reforms will be the enactment of the proposed Hydrocarbons Law (*Ley de Hidrocarburos*) and the Hydrocarbons Revenue Tax Law (*Ley de Ingresos Sobre Hidrocarburos*). These new statutes will regulate, among other items: (i) the types of exploration and production contracts that will be granted to Mexican and foreign operators as well as joint ventures between certain state-owned companies such as Pemex and private parties; (ii) the rules for the granting of such contracts and execution by the National Hydrocarbons Commission ("CNH") through a public bid process; and (iii) the regulations for midstream and downstream activities. Private parties will be able to enter into a variety of contractual arrangements with the CNH, whether in their individual capacity or in joint venture with Pemex, for the exploration and production of Mexico's oil resources, including (a) cash for services; (b) profit sharing; (c) production sharing; and (d) licenses, which would be similar to mineral leases in the United States. These contracts will be subject to Mexican law, and any disputes arising under such contracts may be resolved by arbitration in Spanish. In the midstream and downstream markets, permits will be granted for oil refining, natural gas processing, manufacturing petrochemicals, and transportation, storage and distribution of hydrocarbons and petroleum products, which will be fully open to private investment through the granting of permits. A significant component of this reform process will be the requirement that all energy projects must be comprised of 25% national content by 2025. This mandate will be phased in over time beginning in 2015. Also significant will be the mandated transparency of the awards process for these contracts. All bid stages will be public. The contracts must include a transparency clause in order for the public to review their content. Finally, private parties will be allowed to book for accounting and financial purposes their exploration and production contracts, as well as the expected benefits from such contracts; provided however,

that at all times, the hydrocarbons located in the subsoil will be considered property of the Mexican State. **Power Generation Reform** Power generation will be restructured with the new Electricity Industry Law (*Ley de Industria Eléctrica*) that will implement the full liberalization of the power generation industry. Currently, the generation of power is dominated by the Federal Electricity Commission ("CFE"), with roughly 80% of Mexico's generating capacity consisting of plants built with state funds, and the CFE maintains exclusive control over the transmission and distribution of power. With these reforms, private parties will be allowed to build, operate, finance and extend transmission and distribution infrastructure as well as power generating plants. The CFE will no longer operate as a monopoly in the power industry as a result of this restructuring. Once the Legislation is approved by the Mexican Congress, a set of regulations, guidelines, administrative rules and forms of agreements will need to be issued in order to make the Legislation fully effective, a process that will take several months. We will continue to monitor the approval process of the Legislation and keep you informed of further developments. Please contact us if you are interested in receiving further information or participating in more detailed discussions on the opportunities presented by these reforms.