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## **ENERGY REFORM IN MEXICO WHEN, HOW, AND WHAT DOES IT ALL MEAN FOR MEXICO AND INDUSTRY PARTICIPANTS?**

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On December 12, 2013, the Mexican Congress approved the amendment of articles 25, 27, and 28 of the Mexican Constitution (the “Amendment”). These changes represent the most ambitious energy reform since the oil industry nationalization in 1938. This Client Alert provides a brief summary of the key terms in the Amendment and includes commentary regarding the overall significance of the Amendment in connection with the Mexican oil and gas industry.

### **I. SIGNIFICANCE**

The Amendment eliminates the Constitutional restriction to use the “contract” as a granting instrument for exploration and production (“E&P”) activities, while maintaining the restriction to use concessions. Also, it effectively relaxes the long-standing *Petróleos Mexicanos* (“Pemex”) monopoly by allowing the Mexican Government, as well as Pemex, to enter into agreements with third parties different from or in addition to the service agreements currently in use, while title to the hydrocarbons will remain with the Mexican Nation. The Amendment also provides for changes in the midstream and downstream oil and gas industry, allowing private party participation as well as private investment in the electric energy sector.

Under the new Constitutional framework, (i) the Mexican Government and/or Pemex may enter into profit sharing agreements, production sharing agreements, license agreements, or others with oil and gas companies; (ii) Pemex no longer has the exclusive authority to carry out E&P activities in Mexico; and (iii) Pemex may strategically partner with private, public, or state-owned oil and gas companies to develop specific projects.

Other key terms of the Amendment include the following:

- Pemex and the state-owned electricity company (“CFE”) will be transformed into “Productive State Companies” following best international corporate practices, instead of decentralized government entities.
- The enacting secondary legislation must be made by the Mexican Congress within 120 days following the effective date of the Amendment.
- The enacting legislation will detail the different types of consideration (cash or in kind) depending on the type of contract as well as the contributions in favor of the Mexican State.
- Pemex and or third parties with a right to perform E&P activities may book their expected economic benefits for accounting and financial purposes.

- Within 90 days following the date of the Amendment, Pemex shall request the Energy Ministry the direct award of the exploration and production areas that it is financially and technically able to operate.
- Within 120 days following the date of the Amendment, the Mexican Congress shall issue enacting legislation to ensure that the contracts between the State, Pemex, and oil and gas companies are awarded through a transparent process; are publicly available to any interested party; contain an efficient audit system to supervise cost recovery mechanisms and other related accounting practices; and the disclosure of consideration, contributions, and any other payment made under the contracts.
- Within 120 days following the date of the Amendment, the Mexican Congress shall issue the necessary modifications to existing laws to strengthen and modify the nature of the energy sector regulating authorities, the Energy Ministry (Secretaría de Energía), the National Hydrocarbons Commission (Comisión Nacional de Hidrocarburos or CNH), and the Energy Regulatory Commission (Comisión Reguladora de Energía).
- The creation of the Mexican Petroleum Fund as a government trust (with the Central Mexican Bank acting as Trustee) to collect and administer all of the income derived from the contracts with oil and gas companies and direct awards to Pemex.

## **II. CONCLUSION**

The Amendment was approved by the majority of the state legislatures on December 15, 2013, which leaves only the publication in the Official Gazette (*Diario Oficial de la Federación*) by the Mexican Congress for the bill to become law. In addition, the Constitutional changes must be regulated and implemented by numerous pieces of secondary legislation. In any case, close attention should be paid to the changes that will come to the Oil and Gas Law (*Ley Reglamentaria del Artículo 27 Constitucional en el Ramo del Petróleo*) and to the renewed oil and gas regulator, the CNH. The Oil and Gas Law will now become equally important or even surpass the Pemex Law as the key law in the Mexican oil and gas industry. The Oil and Gas Law together with its implementing Regulations will need to address issues such as the redefinition of the activities that are reserved to Pemex, all of the details related with the new contracting system, and the role of the CNH going forward, among others.

While many implementing details are still to come, it is important for us to keep you informed of the most ambitious energy reform in Mexico in quite some time. The overall message of the Amendment is a positive one considering Mexico's political/historical context and the fact that the proposed changes open the door to a deep structural change of (i) the Mexican oil and gas sector, (ii) the role Pemex has played since its formation in the Mexican economy, and (iii) the granting instruments currently used in Mexico.

If you have additional questions, do not hesitate to contact the Thompson & Knight attorney with whom you regularly work or one of the attorneys listed below.

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