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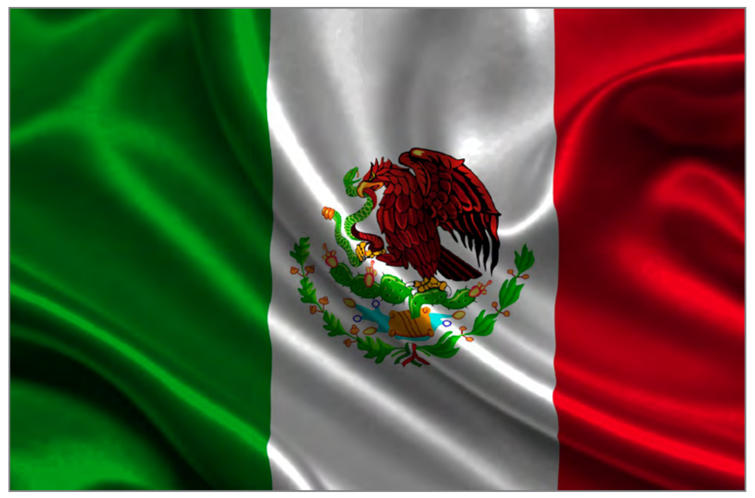
Mexican Energy Bill to boost Investment in Mexico

By Edmond Grieger

Mexican lawmakers recently took an important step to boost Mexico's energy sector, by approving a historic constitutional amendment to overhaul the oil, gas, and electric sectors; which will open the market for national and foreign investors. The energy bill ends a 75 year state monopoly in this sector.

In December 2013, with the vote of the majority of the Mexican Federal and Local Congress Houses, the energy bill was approved and entered into force in order to amend articles 25, 27, and 28 of the Constitution in connection with energy matters. It includes 21 transitory articles which govern certain aspects that are discussed below, as well as the obligation of the Federal Congress to make the necessary adjustments to the existing secondary legal framework which is to date subject to an ongoing process and shall conclude in the following weeks.



The Mexican State will continue to be considered as the owner of all solid, liquid, and gas hydrocarbons that are found under Mexican soil. However, it is provided that the State will have several contractual schemes that will benefit foreign and local investors in this sector. The type of contracts that may be executed include rendering of services (which is the type currently used), profit or production sharing, license agreements, or a combination of all the above. In the profit sharing agreements, the contractor would make the investment in the works at its own risk while the State agrees to pay a percentage of the profits as compensation. In the shared production agreements, the State agrees to pay a percentage of the production obtained as compensation. For license agreements, companies will be allowed to drill and reap the benefits of what they produce once these hydrocarbons are extracted from the subsoil.

The authorities head of the energy sector in Mexico: Petroleos Mexicanos ("PEMEX") and the Federal Electricity Commission (*Comisión Federal de Electricidad*) ("CFE"), will be transformed, changing within two years from the entrance into force of the reform, from public government bodies to *"productive enterprises of the State"*, responsible for their respective strategic areas of development, and authorised to receive allocations and enter into contracts.

PEMEX will have the sole discretion to decide in which contracts it will desire to participate alongside with the private sector, which is the normal course of action of any private entity in order to decide whether to participate or not in a certain commercial activity. In this regard, PEMEX will have the discretion not to participate in contracts in which PEMEX detects an important risk such as the exploration and extraction in deep waters and non-conventional sources, which will leave a door open for foreign and national companies that have the necessary infrastructure and know-how to execute these type of contracts.

Furthermore, four new Control Centers are created by the reform; (i) the Mexican Petroleum Fund; (ii) the National Energy Control Center; (iii) the National Center for Control of Natural Gas; and (iv) the National Agency for Industrial Security and Environmental Protection of the Hydrocarbons Sector. The Mexican Petroleum Fund is considered as a public trust, in which the Banco de México, as trustee, will concentrate all the income from the contracts, except for the contributions from the State. Regarding the National Energy Control Center, the reform considers the same as a government agency that will have the operating control of the National Power System. The National Center for Control of Natural Gas is considered as a government agency responsible for the operation of the national system of transport and storage pipelines; and finally, the National Agency for Industrial Security and Environmental Protection of the Hydrocarbons Sector, will be responsible for the environmental

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control and regulation related to installations, platforms and activities in this specific sector.

In the electricity sector, the State will continue to be responsible for the public services of transmission and distribution of electricity. The generation and sale of electricity will be open to the private sector, which will sell its power through the transmission and distribution networks of the State. Under security and quality control standards, open and equitable access to the transmission and the distribution networks will be guaranteed. With the foregoing the generation and commercialisation of clean and renewable energy will be boosted as well.

Finally, one of the most important matters regarding the energy reform is the issuance of the secondary legislation surrounding the same. In this regard, the secondary legislation must have been approved and published since April, 2014. Notwithstanding the above, it was 30 April 2014 that the President submitted before Federal Congress several initiatives regarding the secondary legislation. These initiatives make up 9 blocks that refer to different specific subjects such as, hydrocarbon; geothermal energy; electricity; the productive enterprises of the State; taxes; budget; and the Mexican Petroleum Fund.

From the discussions that are being held in the Senate, some of the most relevant aspects that are being discussed at the moment are the following:

- The new Electric Industry Act will establish the structure of a new electricity market in Mexico with important participation of foreign and national private companies in the generation and commercialisation of electricity in the Country. In addition, the State will establish the minimum percentage of renewable energy that must be generated annually. Such percentage must be met by the generators and suppliers of electricity throughout the Country. In this regard, the new Electric Industry Act will provide that in case that the generators and suppliers do not comply with the percentage assigned to them, they shall acquire Clean Energy Certificates in order to compensate their lack of renewable energy generation. Once that the generators and suppliers have their Clean Energy Certificates, they will have the option to sell both the electricity that they generate, as well as their Clean Energy Certificates.

- There is a strong engagement towards implementing transparent public bidding procedures to award contracts in these sector and make most of the information related to these procedures available through effective electronic systems.

- The new Hydrocarbon Act will emphasize that the exploration and extraction of hydrocarbons will solely be made by the Government through assignees and contractors and will also contain the provisions to allow the participation of the private sector, as well as of foreign investment, in various sectors of the industry.

- The new Geothermal Energy Act will establish and endorse procedures in order to obtain concession titles for the exploitation of geothermal reservoirs.

On the other hand, the National Infrastructure Program (PNI) issued on 29 April 2014 contains goals, strategies, and action plans that reflect the priority activities in infrastructure, which will be driven by the Federal Government in this Administration. Among such priority activities are those related to the transmission infrastructure in electric sector, as well as transport pipelines in the Oil & Gas sector. The PNI includes a strategy that will consider the promotion and development of the south-eastern region (Campeche, Chiapas, Guerrero, Oaxaca, Quintana Roo, Tabasco, Veracruz, Puebla, and Yucatan), which has a large potential in energy generating resources.

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Also, the PNI estimates that the national electricity consumption will increase 27% by 2018 compared to the consumption registered in 2012. Such growth is expected to be attended by the construction of 25,184 MW of additional installed capacity through the mechanisms that will be provided by the secondary legislation with the participation of the private sector.

To conclude and in accordance with several declarations of representatives and senators, we could expect the secondary legislation for the energy sector to be approved before August 2014.

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