May 1, 2014

Mexico Energy Reform: Secondary Legislation Presented to Congress

Mexico's comprehensive energy reform advances and reflects lessons from the Brazilian experience.

On April 30, the administration of President Enrique Peña Nieto presented a package of much-anticipated bills to the Mexican Congress for secondary legislation with respect to Mexico's energy reform (the Energy Reform), which opens the door to domestic and foreign private investment in Mexico's energy sector.[1] Private investment in the sector will occur gradually as necessary infrastructure is made available, said Pedro Joaquín Coldwell, head of the Energy Department (*Secretaría de Energía*). The one exception is the retail sale of gasoline, where Secretary Coldwell has confirmed that private companies will not be allowed to immediately open gas stations to compete with *Petróleos Mexicanos* (Pemex), Mexico's state oil company.

The package of bills presented to Congress consists of 13 amendments to existing secondary energy legislation as well as nine new laws (the Secondary Legislation Package). Although the Secondary Legislation Package was due to be presented on April 20, its delayed delivery appears to have been the result of political frictions between the *Partido Acción Nacional* and the *Partido Revolucionario Institucional*, whose combined efforts made way for the constitutional amendments needed for the Energy Reform.

During the announcement of the Secondary Legislation Package, Secretary Coldwell highlighted the Mexican government's goal to ensure 25% "national content" in energy projects by 2025, with the intent to grow and strengthen Mexico's oil and gas industry. That national content will vary on a case-by-case basis and will be detailed in public bidding guidelines. Further, with respect to cross-border reservoirs and related exploration or production projects, the government announced that the private sector will be obligated to include Pemex for a minimum interest of 20%, although Pemex is not required to be the operator. Importantly, Mexico seems to have learned from Brazil's mistakes, where the local content requirements can be as high as 55% for the development phase of the pre-salt offshore fields and where Petrobras, Brazil's semipublic energy corporation, must be the operator of all pre-salt projects.

Secretary Coldwell also noted the following, with respect to petroleum matters:

- The contracting arrangements contemplate profit sharing, production sharing, and licensing.
- Awards will be made to the companies that offer the best terms for the Mexican state.
- Contracts will not be the responsibility of any single agency in order to allow for the possibility of checks and balances.

The Energy Department will provide technical guidelines, the Treasury Department (*Secretaría de Hacienda y Crédito Público*) will establish the tax system, and the National Hydrocarbons Commission (*Comisión Nacional de*

1. For more information on the Energy Reform, see our previous LawFlashes on the topic: "Mexican Government to Consider Overhaul of Energy Sector," available at http://www.morganlewis.com/pubs/EnergyTrans_LF_MexicanGovtConsiderOverhaulOfEnergySector_15aug13; "Reform Opens Door to Private Investment in Mexico's Energy Sector," available at http://www.morganlewis.com/pubs/EnergyTrans_LF_ReformOpensDoortoPrivateInvestment_11dec13; and "Update: Last Obstacle Cleared for Mexican Energy Reform," available at http://www.morganlewis.com/pubs/EnergyTransLF_LastObstacleinMexicanEnergyReform_17dec13.

Hidrocarburos) will be responsible for procurement, processing, and contract administration.

Luis Videgaray Caso, head of the Treasury Department, noted that the Secondary Legislation Package includes two new tax laws: the Hydrocarbons Income Law (*Ley de Ingresos sobre Hidrocarburos*) and the Mexican Petroleum Fund for the Stabilization and Development Act (*Ley del Fondo Mexicano del Petróleo para la Estabilización y el Desarrollo*). In addition, amendments have been proposed to preexisting secondary tax legislation. The Secondary Legislation Package calls for variation of the fiscal burden imposed on companies depending on the contract. Secretary Videgaray indicated that there are three primary goals for the proposed tax energy reforms: (i) to promote private investment and growth; (ii) to strengthen Pemex and the *Comisión Federal de Electricidad*, making each a more efficient, productive, and competitive enterprise; and (iii) to guarantee an orderly fiscal transition that will allow the Mexican state to satisfy its essential obligations with respect to public investment, health, and education. Secretary Videgaray also pointed out that the proposed Secondary Legislation Package would significantly decrease Pemex's fiscal burden from 79% to 65% on average.

It is important to note that the Secondary Legislation Package does not come without challenges as it enters a fractured and troubled Congress, and the legislation faces a certain degree of skepticism and popular opposition. These factors may delay the negotiation process and enactment of the bills included in the Secondary Legislation Package.

Contacts

If you have any questions or would like more information on the issues discussed in this LawFlash, please contact any of the following Morgan Lewis lawyers:

Houston

Carlos Treistman	713.890.5150	ctreistman@morganlewis.com
David F. Asmus	713.890.5718	dasmus@morganlewis.com
Rodrigo Dominguez Sotomayor	713.890.5155	rdominguez@morganlewis.com
Brian A. Bradshaw	713.890.5770	bbradshaw@morganlewis.com
Humberto Padilla Gonzalez	713.890.5164	hpadilla@morganlewis.com

Morgan Lewis's Global Energy Transactions and Latin America Practices

The lawyers in our Global Energy Transactions Practice draw on their transactional and regulatory capabilities, global resources, and command of industry- and region-specific issues to efficiently advance clients' interests in a broad array of matters, including some of the industry's most complex and significant projects, mergers and acquisitions, power sales, regulatory issues, construction contracts, project financings, and related structured financings. Morgan Lewis's Latin America Practice include multijurisdictional lawyers who are licensed to practice law in Mexico and the United States and who regularly advise clients on cross-border energy transactions throughout Latin America.

About Morgan, Lewis & Bockius LLP

Founded in 1873, Morgan Lewis offers more than 1,600 legal professionals—including lawyers, patent agents, benefits advisers, regulatory scientists, and other specialists—in 25 offices across the United States, Europe, Asia, and the Middle East. The firm provides comprehensive litigation, corporate, transactional, regulatory, intellectual property, and labor and employment legal services to clients of all sizes—from globally established industry leaders to just-conceived start-ups. For more information about Morgan Lewis or its practices, please visit us online at www.morganlewis.com.