
energy transactions

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Mexican Government to Consider Overhaul of Energy Sector

Mexico considers private investment in its nationalized oil and gas industry, with two competing proposals currently under review in its Congress.

On July 31, the *Partido Acción Nacional* (PAN), former President Felipe Calderón's and Mexico's main right wing opposition political party, submitted a bill (the PAN Proposal) to the Mexican Congress proposing a constitutional amendment to allow private and foreign investors to participate in Mexico's oil and gas and electricity sectors, which have been governmental monopolies for more than 75 years. The proposed overhaul of the system would also broaden the participation of private and foreign investors in gas-related activities. Following the PAN Proposal, on August 12, President Enrique Peña Nieto and the *Partido Revolucionario Institucional* (PRI) submitted their own energy bill to Congress (the PRI Proposal), which, although less ambitious than the PAN Proposal, would still represent a complete overhaul of Mexico's rigid energy legal framework.

The proposals indicate that energy legislation reform in Mexico is finally becoming a reality, with tremendous potential for domestic and foreign energy companies. The reform is expected to include a radical change to the legal framework for oil and gas production and power generation in Mexico.

PAN Proposal

With respect to the oil and gas sector, the PAN Proposal seeks to end the state monopoly over the upstream, midstream, and downstream activities and replace it with a concession system that would allow private parties to participate in such activities. Private parties would acquire title to the hydrocarbons at the wellhead after paying all applicable fees and taxes; however, it is unclear whether reserves may be booked before the hydrocarbons are extracted. This issue would presumably be addressed through secondary legislation. Under the concession system, the already existing National Hydrocarbons Commission would be granted the authority to award concessions through international public bids open to state-owned and private companies.

With respect to power generation, the PAN Proposal would repeal the current regime—which allows private parties to generate power only for self-consumption and co-generation with the *Comisión Federal de Electricidad* (CFE), the Mexican state-owned power company, and for export abroad—and replace it with one that allows private parties to freely generate, transmit, distribute, and market electricity. Nuclear power and the use of radioactive materials would continue to be limited to the state.

PRI Proposal

With respect to upstream activities, the PRI Proposal departs from the PAN Proposal's concession-based system and moves closer to a profit-sharing regime in which (i) Pemex, the Mexican state-owned petroleum company, would retain ownership of all hydrocarbon reserves and (ii) private parties would receive a cash payment for hydrocarbons produced. It is unclear from this proposal whether the profit-sharing agreements would allow the booking of reserves in accordance with the U.S. Securities and Exchange Commission's rules, but, according to some public statements by the Mexican Subsecretary of Energy following the announcement of the PRI Proposal, the reform would be implemented in a manner that would allow it. Under the PRI Proposal, private investors would also be able to participate in midstream and downstream activities.

With respect to power generation, the PRI Proposal would also (i) open the door for power generation to be undertaken by private investors and (ii) limit the control of the CFE to transmission and distribution activities.

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Next Steps

This historic proposed energy reform marks a potential turning point for a country that was the first big oil producer to nationalize its oil industry in 1938. In order to pass these constitutional amendments, either one of the proposed bills or a negotiated settlement will have to be approved by two-thirds of the Mexican Congress and by 17 of the 32 state legislatures. Then, it will be submitted back to Congress for presentation of the final bill to the president, who must sanction and sign the bill into law, at which point it will be published in the *Mexican Federal Official Gazette*. According to political think tanks, the chances of the reform now being passed are significantly higher than in previous attempts because the two largest political parties (PRI and PAN) are in agreement with respect to the need of a comprehensive energy reform. Both PRI and PAN have enough votes to pass the reform through the Senate and, although they are a few votes short from reaching the two-thirds majority necessary to pass the reform through the House of Representatives, this hurdle is expected to be overcome by crossing the aisle and reaching an agreement with one of the minor political parties that have historically aligned their votes with either one of these two parties. According to an interview given by Emilio Lozoya Austin, Pemex's CEO, after the announcement of the PRI Proposal, there is optimism and high expectations to successfully pass the bill and enact it into law before the end of 2013.

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