



THE RULE OF LAW AND MEXICO'S ENERGY REFORM

The New Energy System in the Mexican Constitution

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About the Study: The Rule of Law and Mexico's Energy Reform/Estado de Derecho y Reforma Energética en México

The 2013 changes to the constitutional framework and the summer 2014 enabling legislation in Mexico's energy industry represent a thorough break with the prevailing national narrative as well as the political and legal traditions of twentieth century Mexico. Mexico is about to embark on an unprecedented opening of its energy sector in the midst of important unknown factors, as well as a fiercely competitive and expanding international energy market. Mexico is one of the last developing countries to open its energy sector to foreign investment, and although there are important lessons that can be learned from other countries' experiences, this does not imply that the opening will be necessarily as successful as the government promises or that the implementation of the new laws will go smoothly. Almost certainly, after the enabling legislation goes into effect, important questions of law will emerge during the implementation, and unavoidably, refinements to the legislation will have to take place.

The book "Estado de Derecho y Reforma Energética en México," published in México by Tirant lo Blanch and written in Spanish, is the culmination of a major research effort to examine rule of law issues arising under the energy reform in Mexico by drawing on scholars and experts from American and Mexican institutions in order to bring attention to the different component parts of the new Mexican energy sector from a legal standpoint.

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Introduction

On December 20, 2013, Articles 25, 27, and 28 of the Mexican Constitution were amended as part of the so-called “energy reform.” Due to the preeminence of the constitution within the Mexican legal order, the content of these new constitutional precepts will be decisive to the manner in which the Mexican energy system is organized, regulated, and operated, especially in its electrical and hydrocarbons sectors. Therefore, determining the fundamental elements of this reform is essential to understanding both the legal permissions in such industries as well as the restrictions to private investment or other actions that prevail in the system.*

Contrary to the majority of national constitutions, the Mexican Constitution contains broad rules that, on the one hand, regulate the use of certain goods that are necessary for the production of energy and, on the other hand, regulate the activities and services necessary to produce and/or distribute energy (*lato sensu*). Understanding the nature of both elements can only be achieved through a historical analysis of the constitutional dynamics that led to the recent reforms. This is the case because, notwithstanding the fact that some aspects of the Mexican energy system underwent radical changes through the reforms in 2013, some of its structural elements have remained the same regarding the conceptual distinction between sectors, goods, and services.

Based on our identification of the main constitutional elements of the energy system,¹ we will consider the main aspects of the legislative process that led to the constitutional reforms. It is necessary to stress that the approach of this study is to abstract the legal categories of analysis for these constitutional amendments and not to identify the determining factors for the political, financial, or economic decisions that motivated the reform. Afterward, we will separately consider the two most important sectors of the Mexican energy system since the entry into force and effect of the constitutional reform: the hydrocarbons sector and the electrical industry. Finally, we will formulate some brief conclusions derived from these elaborated considerations.

In order to avoid confusion, it is necessary to clarify two fundamental issues. First, this work analyzes the new constitutional framework exclusively and not other legal instruments such as laws, acts, and agreements that already have been—or are about to be—issued. The approach of this text has already been defined previously: Although the constitutional framework may not constitute the total legal framework regarding Mexican energy law, it grants us the possibility to define the regulatory environment from which the rest of the rules are derived.

The second clarification, which is related to the former, is based on the decision by Congress (*Constituyente Permanente*, which is the formal body that amends the constitution) to place a large amount of regulatory content in transitional articles. Unlike general

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legislative practices, this reform made extensive use of transitional articles, not only to establish temporal criterion of regulatory validity or to order that certain operational actions may be conducted by other authorities, but rather also to cover substantial elements of regulatory matters. Therefore, far from only reflecting the specified timeframes for implementation, a comprehensive study of the reform involves carefully considering the different transitional articles. The purpose was not to take the organizations, responsibilities, or processes into account, but rather the content of some precepts that, being incorporated in a standard of supreme hierarchy, must be considered by the administrative or legislative authorities at the time the very standards through which the constitutional reform must be implemented are issued.²

The Constitutional Development of the Mexican Energy System, 1917-2013

Originally, Article 27, paragraph 4 of the constitution established that the nation was the direct owner of, *inter alia*, oil and all hydrocarbons, disregarding its solid, liquid, or gaseous form.³ Paragraph six of the same article established that ownership of these goods was inalienable and not subject to limitations, and that only the federal government could grant concessions to individuals or civil or commercial companies in accordance with Mexican laws, “subject to the condition that regular work must be created for the exploitation of the elements in question and that the requirements that are established by the laws are complied with.”

The latter is important to mention since these two paragraphs were the only explicit constitutional regulation on the matter. On the one hand, there was no other direct reference to electricity, although it is true that, indirectly, it is possible to extract some regulations with respect to—in this case—the water required to produce such electricity. On the other hand, there was no permission or mandate to any public body to exploit or regulate the goods or categorize the activity as being exclusive to the State, as indeed happened with currency, mail service, or telegraphs, for example. Finally, no exclusive duties were granted to the Congress of the Union to legislate in matters of goods or services related to energy.⁴

From a comprehensive analysis of the original text, the constitutional organization of the Mexican energy system was based on three elements: State ownership of certain goods (oil, hydrocarbons, and certain types of waters),⁵ the possibility of direct State exploitation of these goods,⁶ and the possibility of granting concessions regarding their exploitation to individuals, subject to certain conditions.⁷ This was the basis for the future development of the Mexican energy system, which is always subject to the aforementioned categories of sectors, goods, and services. As we will attempt to demonstrate, the successive constitutional amendments were executed in order to regulate, jointly or separately, the goods related to energy, the energy sectors themselves, or the services that may be provided through exploiting the goods in each of the energy sectors. As a matter of fact, and considering the characteristics of the Mexican Constitution, it is one thing to determine what kind of goods are at stake and who their respective owners are, while it is

something different to identify the activities in both energy sectors that can be conducted, which is different from the types of services that are possible within these sectors and under what conditions. The existence of these components requires a matrix analysis to identify the constitutional conditions of the relationship between the three categories indicated above. Without intending to attribute a continuous psychological condition to the reform, which it cannot have due to its nature, we believe that the actual effect of the constitutional reforms was to manipulate these three components; the result of the modifications has created the subsequent Mexican energy system. We believe that by presenting the conditions of analysis for these amendments, it will be easier to understand these modifications, including the 2013 reform.

In 1929, Section X of Article 73 of the constitution was amended in order to grant Congress the power to enact labor laws. However, it was specified that the jurisdictional application regarding these rules corresponded to state authorities, except in the case of disputes over certain subject matters, including, *inter alia*, hydrocarbons. The latter implies that regardless of whether these goods are exploited directly by the State or by private concessionaires, labor conflicts would be resolved by federal judicial bodies. The importance of this legislative change is that, indirectly and incipiently, it provided the basis for the constitutional establishment of the “hydrocarbons” sector, although based on an exclusive jurisdictional purpose. Regardless of the players or the types of services provided, whoever exploits a good of this type and becomes involved in a labor conflict was viewed as part of the sector and had to come before a single federal entity. The use of a good established the hydrocarbons sector, although for the specific purpose of resolving the aforementioned disputes and without specifying anything with respect to the types of services that could be conducted.

The second constitutional modification to this article occurred in January 1934, empowering Congress to legislate in matters of electric energy (Article 73, Section X). What is interesting about this change is that it was heading in a direction different than the amendment related to hydrocarbons. Since electricity is not a public good and, until then, the constitution did not provide for any form of public regulation or intervention in this matter, the Congress of the Mexican Union lacked implicit power to legislate electricity matters, in contrast to the case of oil and hydrocarbons, where the very existence of these resources authorized Congress to regulate such matters. However, with respect to electricity, it would be necessary to grant Congress express powers, unless it was desired that, by virtue of Article 124 of the constitution, the State would legislate such matters residually. The constitution did not directly determine the elements that made up the electrical sector, therefore its regulation was delegated to the ordinary legislator. This implied that, except for the issue of water concessions pursuant to the terms and for the purposes already noted above, there were no constitutional guidelines regarding the concession and utilization of goods, specific methods of providing services by the State or individuals, or any activities reserved for the State itself. Constitutionally speaking, this was an open market in many different respects.⁸

The constitutional reform of 1940 represented a change of utmost significance for the Mexican energy system. Article 27, paragraph four of the constitution established that, insofar as oil and hydrocarbons were concerned—whether solid, liquid, or gaseous—no concessions would be granted to individuals and that the law (regulatory act) would determine the manner in which the nation would exploit these natural resources. As pointed out, before the constitutional amendments, the system was composed by three central elements: State ownership of a few goods, the possibilities of direct State exploitation of these goods, and concessions that would allow individuals to exploit such goods under certain conditions. Through the 1940 modification, these first two were modified, initially because the possibility of direct State exploitation (or not) of the specified goods was not left open, but rather only a duty was imposed upon Congress to establish the means to do so. Secondly, the change intended to ensure that only the State would be able to exploit such goods.⁹ What this reform did was consolidate the concepts we have been discussing into a single unit: the construction of a State petroleum sector through assigning the entirety of the goods and services necessary for its exploitation to the government.¹⁰

In 1960, paragraph seven of Article 27 of the constitution was modified in order to establish the exclusive power of the nation to generate, conduct, transform, distribute, and supply electric energy in order to provide electric energy as a public service. It was additionally ordered that no concessions will be granted to individuals and that the nation would benefit from the goods and natural resources required for such purposes. Other than in the case of oil and hydrocarbons in this respect, insofar as electricity is concerned, there were no public goods that were considered State property. A set of activities, pursuant to the terms of the reform in question, were largely assigned to the states in their entirety,¹¹ both by establishing that the State itself would conduct such activities directly whenever they were related to public service as well as by preventing the participation of individuals. As in the oil reform in 1940, the electrical amendments of 1960 consolidated several concepts: a single State-controlled electrical sector was constituted, to which the entirety of the services necessary to perform them as a public service were assigned.

The nationalization of electric energy led to a related legislative adjustment once Congress had the power to craft laws on the generation (Article 73, Section X), conduction, transformation, distribution, and supply of electric energy as a public service, although also with respect to the remaining activities (*lato sensu*) in the sector that were not directly related to the provision of such service (self-supply or cogeneration, for example).¹²

In relation to the hydrocarbons sector, during the same year, paragraph seven of Article 27 was modified to incorporate two additional principles: a prohibition on granting oil contracts and the ineffectiveness of concessions and contracts granted for such purposes. As previously noted, the prior reforms had granted the State the exclusive power to exploit petroleum resources, thereby establishing a State sector to which all goods and services related to this issue were assigned. The above notwithstanding, a literal interpretation of the revised paragraph seven of Article 27 implied a duty for the State to engage in all activities directly related to the exploration and extraction of oil without the assistance of

third parties, according to which it would be responsible for activities such as the construction of platforms, drilling pipes, and equipment, and even render services such as personnel transportation.¹³ Due to the absurdity of this interpretation and the consequences this would have for the petroleum industry, the general opinion was that the prohibition exclusively referred to so-called “venture contracts.”¹⁴

Until 1983, the Mexican energy system was integrated by the two large sectors mentioned above.¹⁵ At a constitutional level, there were developments in terms of how to integrate each of them, with notable differences in terms of the public goods and services involved. However, in 1983, Articles 25 and 28 of the constitution were amended (along with other important articles) and a different model was created. The effects of this reform were to entrust stewardship of the national economy to the State and involve the public, social, and private sectors in national development. Regarding these three elements, it was established that the State would have to be exclusively in charge of the strategic areas set forth in Article 28 and that the federal government had to maintain ownership of and control over organizations that would be established. Such strategic areas included, among others, oil and other hydrocarbons, basic petrochemicals,¹⁶ radioactive minerals, and the generation of nuclear energy and electricity.¹⁷

This reform presumed that, in addition to the regulations for the two energy sectors mentioned in Article 27, an additional regulatory framework composed by two elements would be established. The first involves classifying the energy sectors as strategic areas or, put differently, reiterating the State’s exclusive management of these systems. The second is establishing that the organizations or companies through which such activities are conducted would be exclusively owned by—or under the control of—the State.

In terms of possible interpretations, it could be said that the establishment of strategic areas did nothing more than organize certain State activities, considering that since the energy sector had its own legal framework, no new regulations were added through the 1983 reform. However, it is possible to identify another, entirely different perspective. The aforementioned reform modified the national energy system to the extent that it increased the regulatory conditions of its three sectors. This would be the case since not only would it be necessary to modify the content of Article 27, for example in matters of goods and services, but rather also Article 28 regarding the exclusivity of the functions related to a so-called strategic area, which is considered exclusive precisely because it is strategic.

Prior to the 2013 reform, the constitution included the sum of the elements we analyzed above with regard to the national energy system. In summary, it can be stated that, for both the separate sectors as well as the collective strategic areas, the system was designed as follows.

With regard to the petroleum sector, the State was the owner of the entirety of related goods (i.e., oil and hydrocarbons), with a monopolistic concentration of all of the services linked to their utilization (*lato sensu*) and absolute control over the organizations or companies involved in any activities related to such utilization.

Regarding the electrical sector, the same monopolistic concentration existed with respect to most of the possible methods of utilizing electric energy for public service (generation, conduction, transformation, distribution, and supply), as well as the aforementioned control of the organizations or companies participating in the respective utilization, and State ownership of some of the consumables necessary for electrical production.¹⁸ As pointed out earlier, based on these factors, the energy reform would need to be conducted—primarily through the disaggregation of goods or services—pursuant to the terms that we will discuss later after considering the main characteristics of the constitutional reform process.

The Constitutional Reforms Process in December 2013

This process started on December 2, 2012, when President Enrique Peña Nieto signed, with representatives from the majority of the domestic political parties—the National Action Party (PAN), the Institutional Revolutionary Party (PRI) and the Party of the Democratic Revolution (PRD)—the so-called “Pact for Mexico.”¹⁹ As a general goal, the pact stated that Mexico would promote “an energy reform that will make this sector one of the most powerful drivers of economic growth by attracting investment, technological development, and the formation of value chains.” More specifically, it stated that ownership of and control over hydrocarbons and the status of *Petróleos Mexicanos* (PEMEX) as a public company would be maintained, with the capacity of competing in the industry until making it a world-class enterprise (Commitment 54). To do so, it was deemed necessary to provide PEMEX with rules of corporate governance and transparency necessary for a productive company of its significance (Commitment 55). Likewise, it was determined that the necessary reforms would be created to favor price competition in refining, petrochemistry, and transporting hydrocarbons without privatizing PEMEX’s facilities (Commitment 57). The reforms would also transform PEMEX into a promoter of the national supply chain (Commitment 59).²⁰

Based on the assumed commitments, on August 12, 2013, Peña presented before the Senate of the Republic amendments to paragraph seven of Article 27 and paragraph four of Article 28 of the constitution, an initiative that was supported by PRI legislators.²¹ Meanwhile, PAN representatives in Congress submitted an initiative to modify Articles 25, 27, and 28 of the constitution with regard to energy matters.²² Finally, on August 19, 2013, PRD legislators presented their initiative to Congress.²³

Specifically, the proposals consisted of establishing changes in tax law, creating budgetary and management autonomy for the organizations involved, and strengthening the Ministry of Energy and the National Hydrocarbons Commission. Additionally, it was proposed to modify rates, prices, and subsidies of fuels and electricity for fair access to energy, and to transform the Oil Revenues Stabilization Fund into a financial organization. To do so, it was recommended to create, add, modify, and repeal different regulatory rules, without considering any constitutional norms.²⁴

After long debates and obvious adjustments, and consideration of the different proposals,²⁵ the reform was finally approved by the Senate on December 11, 2013,²⁶ and by the Chamber of Deputies the following day.²⁷ Upon prior approval by the majority of the legislature, it was published on December 20, 2013 in the Official Gazette. The decree of promulgation establishes the following: “Sole Article—paragraphs four, six, and eight of Article 25, paragraph seven of Article 27, paragraphs four and six of Article 28 are reformed, and a paragraph seven is added, as a result of which the following ones are renumbered, to Article 27, and a paragraph eight is added, as a result of which the following ones are renumbered, to Article 28 of the Political Constitution of the United Mexican States.”

According to the 21 transitional articles, the constitutional reform would come into force and effect at different times. Here, we briefly consider them from a strictly temporal point of view, reserving the material aspects for a later section in which we analyze the constitutional modifications to each of the energy sectors specifically.

Generally speaking, it was established that the decree of constitutional reforms would come into effect on the day following its publication in the Official Gazette, which took place on December 21, 2013. Article 3 determined that, within a maximum period of two years, PEMEX and the Federal Electricity Commission (CFE) would need to be converted into productive State companies and that until then, PEMEX could receive assignments and contracts²⁸ and CFE would execute the contracts.

Article 4 established the general timeframes for the execution of different actions, whether directly or by referencing other transitional articles. Directly, it was established that within 120 days of the entry into force of the decree,²⁹ Congress had to make the necessary adjustments to ensure the effectiveness of the modified provisions, in particular the regulation of the contracting categories and considerations for the benefit of the State. Indirectly, the period set forth in Article 4 was used as the basis for many different references in other transitional articles, conforming with the obligations of Congress.³⁰

Article 17 specified other obligations for Congress, which, insofar as it is relevant for our analysis, are different from the preceding ones only for reasons of time. As a matter of fact, instead of 120 days, Congress was given a maximum period of 365 days to issue legislation regarding environmental protection “in all processes related to the subject matter of this present decree in which productive State companies, individuals, or both participate through the incorporation of criteria and best practices regarding issues of efficiency in terms of use of energy, a decrease in the generation of greenhouse gases and compounds, effectiveness in the use of natural resources, low generation of residues and emissions, as well as the least carbon footprint in all its processes.” It was added that, in matters of electricity, all participants would be required to produce clean energy and reduce contaminating emissions (Article 17).

Finally, the constitutional reforms to transitional article 16 required the federal executive branch to conduct certain regulatory actions within certain periods of time. The most important of these are: first, within 12 months after the entry into force of Article 27, the

federal executive branch had to establish the National Natural Gas Control Center, a decentralized organization in charge of operating the national transportation and storage pipeline system; second, within the same period of 12 months following the entry into force of the reforms for the electrical industry, the federal executive branch had to create the National Energy Control Center as a public decentralized organization in charge of operating the national electric system.

The Constitutional Reform of December 2013

Based on our description of the main elements of the constitutional reforms process and the most relevant aspects of the transitional rules set forth in the decree, we proceed to address the most relevant factors of the December 2013 constitutional change in the two industries that predominantly constitute the Mexican national energy system.

Hydrocarbons Sector

The December 2013 constitutional reform of Article 27, paragraph seven; Article 28, paragraph four; and Article 25, paragraph four modified the organization and structure of the hydrocarbons sector, as described above. With regard to the structure of State ownership of the entirety of related goods, there were no profound changes. However, regarding the monopolistic concentration of all services linked to the use of hydrocarbons (*lato sensu*) and absolute control of the organizations or companies involved in any activities related to such use, there was an important restructure of the system.

According to paragraph seven of Article 27, solid, liquid, and gaseous oil and hydrocarbons located in the subsoil continue to be property of the nation. Their inalienable and imprescriptible character is maintained, and it is not possible to grant concessions with respect to their use. Until this point, it might seem that the reform did not make any change whatsoever if we consider that the constitution establishes that only the nation will be able to conduct oil and hydrocarbons exploration and extraction activities as specified, since this was the legal structure prior to the reform. In this regard, the first modification consists of the diversification of activities: the statement that “the nation will carry out the exploitation of these products” (an expression referring to the entirety of the goods and activities)³¹ was replaced by the separation of only those regarding “exploration and extraction.” The result was the abandonment of the entirely prohibitive model of “exploitation” and the implementation of the model permitting anything other than “exploration and extraction.”³²

As a result, it appears that the second modification was made because it not only affected activities, but it also affected the legal structure regarding the natural resources. This is the case because, prior to the reform, both natural resources located in the subsoil as well as those that were extracted from it were subject to the general rule of exploitation; today, only natural resources located in the subsoil before or during the extraction process are deemed public resources of the State.

The third and perhaps most important modification is that, unlike the case of total participation of the State that applied prior to the reform, there are different manners in which already diversified energy activities can be conducted. The classifying core of any model is the duality of exploration/extraction, since there are activities that can be done within this conceptual duality and others that may occur outside the scope of it. For the sake of method, it is first necessary to define those outside of this conceptual dichotomy.

As previously stated, as soon as oil and hydrocarbons have been extracted, they cease to be in the subsoil and, therefore, cease to be owned by the nation. Their trading and use may be conducted through permits issued by the State authority or through contracts between the productive State companies and the commercial companies that conduct the exploitation activities.

The latter condition is not directly specified in the reformed constitutional precepts. It can be implicitly inferred from two sources. First, an *a contrario sensu* interpretation of Articles 25, 27, and 28 reveals that what is not reserved for the nation, and with respect of which there is no monopolistic protection, is understood to be open to trading, subject to general regulations for any type of goods. Second, and more specifically, this interpretation can be anchored in different transitional articles of the 2013 reform itself. Transitional article 10 establishes that the Ministry of Energy has the power to grant permits for oil treatment and refining and the processing of natural gas, while the Energy Regulatory Commission is in charge of “the regulation and granting of permits for the storage, transportation, and distribution via oil pipelines of any oil, gas, petroleum, and petrochemicals; the regulation of access by third parties to pipelines for the transportation and storage of hydrocarbons and their derivatives; and the regulation of first-hand sales of such products.”³³

Even though these agencies do not cover all of the activities that may be conducted after exploration and extraction has occurred, they do demonstrate that there are rules or a series of rules that are clearly differentiated for these vertical activities. It is necessary to emphasize that the applicable legal framework for post-extraction activities has no relation to the handling of public goods or, of course, with the corresponding assignments or contracts to conduct these activities, but rather with ordinary activities of trading, distribution, etc. of regulated products.

Under the central conceptual classification, the 2013 constitutional amendment established that exploration and extraction could only be conducted through assignments granted or contractual agreements between the nation and State companies or between the State and individuals. Additionally, at the same time, the productive State companies could contract with individuals to perform exploration or exploitation activities for which the companies had received an assignment or entered into a contract. Viewed separately, here lies the most important change of the reform. It is necessary to recall that before these amendments were adopted, any exploitation of oil and hydrocarbons were performed by the nation, in all cases through the corresponding State agencies and companies. Now, quite to the contrary, the possibilities have diversified not only with respect to the activities

themselves (exploration/extraction vs. exploitation) but also regarding the players that can participate in the process.

The owner (nation) of the goods (oil and hydrocarbons) can assign to or contract with a State-owned company (productive State company) for the direct exploration and/or extraction of those goods (or allow them to subcontract with an individual to do so),³⁴ or contract directly with an individual to perform such exploratory or extractive activities with respect to goods that, until such time, continue to be the State's property.

The preceding paragraph describes the core element of the reform. As previously stated, one of the particularities of the 2013 amendment is that a series of transitional precepts establishes a great part of the system's performance conditions. Therefore, this must be complemented by regulatory content.

In this regard, it is important to raise the following question: What is the significance of national ownership with respect to oil and hydrocarbons in the subsoil? Who or what represents the nation, and how is its representation maintained? Without analyzing the legislative discussions regarding its original meaning in the 1917 Constitution,³⁵ we may say that the constitutional reforms in transitional article 10 basically granted the Ministry of Energy the authority to award assignments and granted the National Hydrocarbons Commission "the authorization of services of surface reconnaissance and exploration; the performance of biddings; the awarding of contracts to the winners; and the signing of contracts for activities of exploration and extraction of solid, liquid, or gaseous hydrocarbons and administration in technical matters of assignments and contracts." Considering that, according to Articles 28 (paragraph eight) and 90 of the constitution, both agencies are subordinate to the president of the Republic, it may well be said that, ultimately, the nation is represented through the actions of the agents of the federal executive branch, while the exercise of those actions, at the same time, is via the two agencies just mentioned.

The second element to be considered refers to assignments and contracts. On the one hand, assignments are administrative acts through which the Ministry of Energy assigns the exploration or extraction of oil or hydrocarbons located in the subsoil to productive State companies. For such purposes, the ministry must obtain technical assistance from the National Hydrocarbons Commission, which will submit the award itself for consideration. The award must contain the surface, depth, and duration; consider the coexistence of different petroleum fields in a defined area (transitional article seven); and be conducted under conditions of maximum transparency (transitional article 10).

On the other hand, contracts are agreements documenting the meeting of the minds between the National Hydrocarbons Commission—whose purpose is to assign, on behalf of the nation, the exploration or extraction of oil or hydrocarbons—and the productive State companies or individuals who win a bid. Such contracts and the bidding guidelines will be designed by the Ministry of Energy (transitional article 10) depending on, *inter alia*, types of services, shared profit or production agreements, or licensing contracts (transitional article

four),³⁶ and their wording must guarantee maximum transparency. Specifically, it is required that any interested parties may consult them, that an external auditing system must exist to supervise the effective recovery of costs generated by the execution of the contracts themselves, and that the considerations, contributions, and payments specified in them must be disclosed (transitional article nine).

With respect to these assignments and contracts, transitional article four establishes the methods of payment by the State,³⁷ which, *inter alia*, include: “I) cash, for service contracts; II) a percentage of profits, for profit-sharing agreements; III) a percentage of the production obtained, for shared production contracts; IV) the transfer for consideration of hydrocarbons as soon as they have been extracted from the subsoil, for licensing contracts; or V) any combination of the above. The nation will choose the method of consideration, always striving to maximize income to achieve the greatest benefit for long-term development.”³⁸ On the other hand, transitional article five establishes that productive State companies that obtain an assignment or enter into a contract to perform oil or hydrocarbons exploration and extraction activities, as well as individuals who sign a contract with the State or some productive State company for the same purpose, will be able to report, for accounting and financial purposes, the respective assignment or contract and the expected benefits, provided that it is established in the assignments or contracts that the goods located in the subsoil are the property of the nation.³⁹

The following element to be considered refers to the productive State companies, which are the entities that can be awarded assignments. From an exclusively constitutional point of view, in matters of hydrocarbons, these companies are Petróleos Mexicanos and its subsidiaries (transitional article six).⁴⁰ Additionally, transitional article 20 establishes that with respect to productive State companies in general—and PEMEX and its subsidiaries in particular—whenever approving regulatory bills, Congress must establish that: *i*) their institutional purpose is the creation of economic value and to increase the nation’s revenue, *ii*) these institutions have budgetary autonomy, which can only be limited to the financial balance and ceiling of personal services that are approved by Congress, *iii*) “their corporate organization, administration, and structure are in line with the best international practices, ensuring their technical and management autonomy, *iv*) a special contracting system is established for obtaining the best results through their activities, in order for their governing bodies to have the necessary powers to determine their institutional arrangement,” *v*) its governing bodies must comply with the provisions of the law, and its directors are appointed and removed freely by the federal executive branch or, as the case may be, removed by the board of directors,⁴¹ *vi*) that they must coordinate their actions with the federal executive branch in order for their operations not to increase the financial costs of the public sector, and finally, *vii*) that they must have special rules in matters of acquisitions, rentals, services and public works, budgeting, public debt, and administrative responsibilities that allow them to compete efficiently in the industry or activity in question.⁴²

As previously mentioned, in paragraph seven of Article 27 of the constitution and in different transitional articles, it is established that oil and hydrocarbons exploration and extraction may be conducted by productive State companies or by individuals with whom the State has contracted—or with whom the productive company has contracted in accordance with an assignment that has been awarded. In this regard, it is relevant to ask: Who are the players or entities referred to as “individuals” by such constitutional precepts? Under the existing constitutional framework, no specific determinations have been added with respect to the legal nature or limitations to which the contracting parties will be subject.⁴³ This matter is governed by further regulatory bills.⁴⁴

Another part of the constitutional amendments is related to the state bodies. In some cases (i.e., Ministry of Energy, National Hydrocarbons Commission, and Energy Regulatory Commission), the establishment of their institutional design was a matter of modifying certain rules. However, in other cases, the institutional framework of some entities had to be created *de novo* (i.e., National Natural Gas Control Center; National Agency for Safety, Energy, and Environment; National Hydrocarbons Information Center; and Mexican Oil Fund for Stabilization and Development).⁴⁵ In this regard, it is relevant to analyze the new institutional design of some of these governmental bodies.

Article 33 of the Organic Law of the Federal Public Administration establishes the different powers of the Ministry of Energy. In addition to those provided in this law, powers prescribed in transitional articles six and 10 of the energy reforms must be added, namely: *i*) to award the assignments and select the areas that may be covered by the contracts referred to in paragraph seven of Article 27 of the constitution, with the technical assistance of the National Hydrocarbons Commission, *ii*) to technically design such contracts and the guidelines that must be observed during the respective bidding processes, and *iii*) to grant permits for oil treatment and refining and natural gas processing.⁴⁶

Regarding the National Hydrocarbons Commission, transitional article 10 established that Congress must incorporate certain elements in the law regarding technical assistance to be provided to the Ministry of Energy, the gathering of geological and operational information, the authorization of surface reconnaissance and exploration services, the performance of bids, the selection of winning bidders, the signing of contracts for hydrocarbons exploration and extraction activities, technical administration of assignments and contracts, supervision of the extraction plans, and the regulation of hydrocarbons exploration and extraction.⁴⁷

A similar framework applies to the Energy Regulatory Commission, which is subject to the same guidelines as the National Hydrocarbons Commission, since transitional article 10 defines the powers that must be assigned to it by Congress, many of which have been included in other laws cited:⁴⁸ to regulate and grant permits for the storage, transportation, and distribution via pipelines of oil, gas, petroleum, and petrochemicals, and to regulate access by third parties to the pipelines for the transportation and storage of hydrocarbons and their derivatives as well as first-hand sales of such products.⁴⁹

Transitional article 16 establishes that, within a period of 12 months, the federal executive branch must create the National Natural Gas Control Center as a public decentralized organization⁵⁰ that will be in charge of operating the national transportation and storage pipeline system. For such purpose, it is established that Petróleos Mexicanos and its subsidiary agencies will transfer both the funds necessary to “purchase and administer the infrastructure for transportation via pipeline and storage of natural gas owned by them to provide the service to the respective users,” as well as contracts entered into by PEMEX to administer the infrastructure.

Transitional article 19 establishes that Congress must adjust the legal framework to create the National Agency for Safety, Energy, and Environment, a decentralized administrative body of the Ministry of Environment and Natural Resources with technical and management autonomy. Likewise, it was established that it would be up to the agency to “regulate and supervise, in matters of industrial safety, operational safety, and environmental protection, the facilities and activities of the hydrocarbons sector, including activities of dismantling and abandonment of facilities, as well as comprehensive control of residues.”⁵¹

Finally, regarding the design of institutional powers in the 2013 constitutional amendment, transitional article 14 established the Mexican Oil Fund for Stabilization and Development as a public trust, for which *Banco de México* would act as a fiduciary.⁵² It was established that this fund would receive all revenue resulting from the assignments and contracts referred to by paragraph seven of Article 27 of the constitution, except for taxes. Likewise, it was established that such revenues would be administered and distributed in accordance with the following priority: payments specified in such assignments and contracts; transfers to the Oil Revenues Stabilization Fund and the Stabilization Fund for Federal Entity Revenues; transfers to the Hydrocarbons Extraction Fund to support research in matters of hydrocarbons and energy sustainability and petroleum inspection; transfers to the Ministry of Public Finance and Credit the necessary resources that, of the federal government’s petroleum revenues, are intended to cover the federal budget each year; and funds for long-term savings, including investment in financial assets.⁵³

Now that the substantive elements with respect to the productive State companies and the centralized and decentralized public administration bodies indicated in these constitutional amendments have been described therein, it is important to remember that, as established in paragraph four of Article 25 of the Constitution, the State must maintain control over and ownership of both one and the other.⁵⁴

Electrical Sector

As already discussed, prior to the December 2013 reforms, the economic structure of the electrical sector was composed of a monopolistic concentration of a majority of the electric energy activities used for public service (generation, conduction, transformation, distribution, and supply) as well as a system of control over the bodies or companies that participated in the corresponding electric energy utilization. As a result of the reform process, fundamental changes to the sector were included in the final part of paragraph six of Article 27 and in paragraph four of Article 28: *i*) that the planning and control of the

national electric system as well as the public service of electric energy transmission and distribution is an exclusive matter of the nation; *ii*) that no concessions would be granted for either of those activities; *iii*) that the State is entitled to enter into contracts with individuals with respect to these activities, pursuant to the terms established by the laws; and *iv*), that individuals may participate in the other electrical sector activities in accordance with the provisions in the respective legislation. Since Article 25, paragraph four of the constitution was not modified, the State maintained control over the companies and bodies in the electrical sector with respect to the regulatory activities and abovementioned possibilities.

The differences between the provisions in the constitution before and after 2013 are notorious. From State monopolistic control over practically all of the activities that may take place in the electrical sector (generation, conduction, transformation, distribution, and supply),⁵⁵ the State only retained the power of planning and controlling the national electric system and the public service of electric energy transmission and distribution. Likewise, for all other activities, the possibility of participation by individuals, whether directly or as a contracting party with the State itself, was created.

The constitutional amendments in both sectors described above can be summarized in the following manner: from the point of view of the State, the nation exclusively maintains planning and control over the national electric system and the provision of electric energy transmission and distribution as a public service; the possibility to enter into contracts with individuals to provide such public service; and exclusive regulation of the national electric system and legal determination of the conditions under which individuals may participate. From the point of view of individuals, it remains clear that they can be parties to contracts entered into with the State related to the provision of the public service of electricity transmission and distribution and that they will be subject to the determinations of State agencies in terms of planning and control over the national electric system. Likewise, it is clear that they will be able to directly participate in different activities of the sector. The important issue to define, from a constitutional point of view, is what these activities are, precisely.

When directly comparing the constitutional rules already repealed and those currently in force and effect, it would seem clear that, since the constitution previously exclusively reserved the right to engage in the generation, conduction, transformation, distribution, and supply of energy to the State and now the State can only conduct transmission and distribution under these specific conditions, individuals may generate, conduct, transform, and supply electric energy by themselves in conformity with the laws. The problem to be considered is whether things occur strictly on such basis or whether, to the contrary, there are other elements that must be taken into account. In accordance with transitional article 10, it appears difficult for us to maintain such strict applications. This article establishes that the Energy Regulatory Commission will be authorized to grant permits for power generation and to establish transmission and distribution rates. From our point of view, this rule divided the activities of the electrical sector into two large segments: on the one hand, energy generation, and on the other, transmission and distribution. Therefore,

individuals have the opportunity to participate in energy generation under open conditions and subject to legal regulations, while the State will be in charge of transmission and distribution, which it may perform either by itself, through the respective companies and organizations, or via the signing of contracts with individuals to provide or perform those aspects that it deems reasonable.

As we have indicated with respect to oil and hydrocarbons, one important part of the legal possibilities of the electrical sector has been clarified in transitional articles of the decree of promulgation. Therefore, it is necessary to consider their content. As such, it must be pointed out hereinafter that, since this does not involve any public goods, but rather possible activities, the regulation is much more scarce.

What is the regulatory scope affirming that planning and controlling the national electric system as well as the public service of electric energy transmission and distribution is an exclusive power of the nation? Maintaining the same reservations we expressed when addressing oil and hydrocarbons, it should be pointed out that the reform established in transitional article 10 that the Ministry of Energy would set the terms of strict legal separation required to foster open access and efficient operation of the electrical sector and ensure its compliance, whereas the Energy Regulatory Commission would be in charge of regulating the granting of permits to generate electric energy and establish electricity transmission and distribution rates. As we have also pointed out, considering that, based on paragraph eight of Article 28 and Article 90 of the constitution, both agencies are subordinate to the president, the federal executive branch represents and acts on behalf of the nation, exercising those powers through the specified institutions.

It is now necessary to analyze the legal tools that were introduced to the legal framework in matters of electricity. Based on our perspective, there are five new tools that are fundamental for a functional understanding of the system. The first one can be implicitly identified with the condition of State regulatory exclusivity, which, in principle, implies that the nation has to plan and control the national electric system and render the public service of electric energy transmission and distribution through State agencies and productive State companies. Other than in the case of the assignments provided for in the petroleum field, here, no particular legal title is established, but rather assumed as a matter of fact. The State does what it does based on its powers prescribed in the Constitution and further developed by the laws (Article 27, paragraph six). Secondly, it must be stated that no concessions can be granted in this subject matter (Article 27, paragraph six), as a result of which the rules for the performance of activities by individuals need to be different, as we will point out below. The third act is represented by contracts, i.e., bilateral agreements that create reciprocal rights and obligations between the State agencies and the productive State companies and individuals so that the latter, pursuant to the terms of transitional article 11, conducts the financing, installation, maintenance, management, operation, and expansion of the infrastructure necessary for to provide the public service of electric energy transmission and distribution on behalf of the nation. The fourth act covers the permits that the Energy Regulatory Commission will be able to grant to individuals so that, pursuant to the terms set forth in the laws, they can participate in the generation of electric

energy (transitional article 10). Finally, the fifth act covers the rates referred to by the decree, meaning that the payments individuals must make to the State agencies or companies for the electric energy transmission and distribution they produce.

Other than the terms set forth in the texts of the constitutional reform in matters of oil and hydrocarbons (assignments), in the reform of electrical matters, the participation of any specific productive State company was not indicated beforehand. Once again, it is in transitional articles that we can find details. Transitional article three established the duty of Congress to convert the Federal Electricity Commission (a decentralized organization) into a productive State company within a period of two years from the publication of the reform decree. Transitional article 20 established the conditions legislators had to guarantee for this type of company. Since we have already considered them when referring to PEMEX and its branch offices, here, we will limit ourselves to stating that this means creating economic value and increasing the national income; budgetary, technical, and management autonomies; special rules of contracting; coordination with the federal executive branch; and special rules in matters of acquisitions, rentals, services and public works, budget, public debt, and administrative responsibilities.⁵⁶

In terms of the concept of “individuals,” we can say that, since neither the constitutional precepts nor the transitional articles clarify in any respect who can contract with the Federal Electricity Commission or who can obtain permits for electricity generation from the Energy Regulating Commission, common law applies in this matter.⁵⁷

Several State agencies have been modified or established by the constitutional reform. With respect to the Ministry of Energy, transitional article 10 establishes that the agency would set the terms “of strict legal separation that are required to foster open access and efficient operation of the electrical sector and will supervise its compliance.” Insofar as the Energy Regulatory Commission is concerned, the same transitional article mentions the competencies provided to it by Congress—as already mentioned, regulate the sector, grant permits for electricity generation, and establish rates for its transmission and distribution.

One newly created entity is the National Energy Control Center,⁵⁸ a “public decentralized organization in charge of operational control of the national electric system, operating the wholesale electricity market, open and not improperly discriminatory access to the national network of transmission and the general distribution networks, and any other powers that are determined by law and in its decree of creation” (transitional article 12).⁵⁹

Transitional article 17 establishes that Congress will make adjustments to the legal framework to establish the bases on which the State will seek protection and care for the environment in all processes related to the matters covered by the decree involving productive State companies, individuals, or both, specifying that, in electricity matters, it will establish obligations regarding the use of clean energies and the reduction of contaminating emissions for those participating in the electrical industry. Likewise, transitional article eight established that Congress would enact a law to regulate the reconnaissance, exploration, and exploitation of geothermal resources to take advantage of

the energy resources in the subsoil within the limits of the national territory, in order to generate electric energy or use it for different purposes.⁶⁰

Conclusions

The general outcome of these constitutional amendments can be described in the following terms.

First, the general legal framework has dramatically changed, since the status of oil and hydrocarbons or those of activities and services remain under the exclusive property or control of the Mexican State.

Second, individuals enjoy wide-ranging possibilities of participation with respect to the goods or the performance of the activities in the petroleum and electrical sectors.

Third, a new and complex network of State agencies was established to participate and/or regulate the natural resources and the direct activities of each of the sectors, which we just mentioned.

Fourth, additional agencies and companies were created regarding the actions required to fully cover the goods and activities linked to these sectors and the effect that their actions must generate.

Fifth, the basic structure and competitive environment of all the created bodies is designed more to enhance the effectiveness and operation of the corresponding sectors than to control participants.

Sixth, most likely provoked by political agreements—or, what seems to be a sign of the need to reach them due to the mistrust between party representatives—the amendments were defined in such manner to limit the scope of Congress' decisions in the regulatory bills.

Seventh, the federal government predicts additional economic growth of 0.5 percent for 2018 and 2 percent of GDP for 2015. At the same time, it anticipates the creation of 500,000 new formal jobs in 2018 and 2 million jobs in 2025 as a result of the energy reform. Likewise, the cost of energy and of the national productive park is intended to be lower.

Eighth, the aforementioned benefits will be subject to a series of political and factual conditions, with some issues regulated in the constitution and secondary legislation, which will be of vital importance to obtain such benefits.

Ninth, from our perspective, there are certain matters that must be given special attention, namely: the definition of the legal nature of productive State companies; the correct design of the Mexican Oil Fund to minimize the dependency of public finances on petroleum revenue; and the possibility for *Petróleos Mexicanos* and the Federal Electricity Commission to compete under equal conditions with private companies during bidding

processes for contracts for electric energy exploration and production and supply, respectively. It is also necessary to analyze the possibility of exploiting shale gas deposits that are located in the Northern part of the country, and the uncertainty that will be created by the temporary occupation of lands on sites where hydrocarbons are detected in cases where the owners do not reach agreements with the companies that intend to extract such resources.

Endnotes

¹ It should be pointed out that we will not analyze the aspects of fiscal participations that, since 1942, correspond to the federative entities, including electric energy, gasoline, and other products derived from oil (Article 73, Section XXIX), among others, since they are not decisive for what we want to show here.

² We know that some aspects of transitional articles will be considered in detail in other articles of this volume, although it is important to show their constitutional genesis below.

³ Prior to the entry into force and effect of this article, in Mexico, oil was treated in the same manner as mining resources. During the Viceroyalty era, Spanish legislation distinguished between eminent domain of mines, reserved for the King, and useful domain, which, as a usufruct and subject to compliance with certain rules, was granted to individuals for the exploitation of veins and deposits. During the Mexican independence period, the application of the Mining Ordinances of the Viceroyalty era continued, since the 1824 and 1857 constitutions did not provide for rules of ownership of the natural resources of the subsoil and their utilization. In 1865, Emperor Maximilian I issued a decree that placed the resources of the subsoil under the direct ownership of the nation. The National Mining Code of 1884 repealed the colonial ordinances and established, among other things, that oil and gaseous sources were under the domain of the soil owner, which was exempted from some obligations with respect to the government, such as the administrative step of reporting. In 1901, the Oil Act was enacted, which established rules regarding permits, franchises, concessions, and patents for the explorations of the subsoil on fallow and domestic land, lakes, lagoons, and bonds under federal jurisdiction. For regulation of the subsoil in positive Mexican Law prior to the 1917 Constitution, see: Roberto Ortega Lomelín, *Oil in Mexico, a kidnapped industry* (Mexico: Porrúa-UNAM, 2012); and Oscar Morineau, *Actual rights and the subsoil in Mexico, Mexico City* (Federal District: FCE, 1997).

⁴ This affirmation must be understood based on two meanings: first, according to the provisions in Section XXX of Article 73 of the constitution, Congress held implied authority to regulate rules for oil and hydrocarbon concessions (*Official Journal of the Federation*, 5th Period, Volume XXXIV, p. 812); and second, that Congress held express competencies to legislate matters of national waters, a consumable that is relevant for electrical production (Article 73, Section XVII).

⁵ *Official Journal of the Federation*, 5th Era, Volume XXIX, p. 1460.

⁶ Official Journal of the Federation, 5th Era, Volume LXII, p. 3021.

⁷ Official Journal of the Federation, 5th Era, Volume XL, p. 3155.

⁸ Official Journal of the Federation, 5th Era, Volume LXXII, p. 2462.

⁹ Official Journal of the Federation, 6th Era, Volume CIV, p. 59.

¹⁰ On November 18, 1942, Section X of Article 73 of the Constitution was modified in order to authorize the Congress of the Mexican Union to legislate hydrocarbon matters, i.e., to expressly enshrine a power this entity had been exercising as a part of a correct understanding of the implicit powers conferred to it by Section XXX of the same article.

¹¹ Other than in the case of hydrocarbons and other goods of public domain, electricity is a single good with unique characteristics that determine the activities covered by its production and supply to consumers. It is precisely these technical characteristics (whose physical nature cannot be compared with any other good to be supplied) that have facilitated the traditional business configuration of the sector on the basis of vertically integrated monopolistic organizations and with delimited territorial coverage, connected to the extension of a network in support of the services supplied. Regarding this issue, see Luciano Parejo Alfonso, “The energy system,” in *Lessons of administrative law, economic order, and reference sectors*, ed. L. Parejo, (Valencia: Tirant lo Blanch, 2011).

¹² Official Journal of the Federation, 9th Era, Volume XXX, p. 465.

¹³ Ortega Lomelín, *Oil in Mexico, a kidnapped industry*, p. 102-104.

¹⁴ Therefore, the State, through Petróleos Mexicanos, could enter into agreements with third parties regarding works and the provision of services to ensure the best performance of its activities, subject to two restrictions: i) prohibition of remuneration based on a percentage of products, and ii) prohibition of remuneration with sharing the results of the operations.

¹⁵ In the Official Gazette dated February 6, 1975, the addition of a new paragraph to Article 27 of the constitution was published, according to which it was up to the nation to utilize nuclear fuels for the generation of nuclear energy and regulate their applications for other purposes, necessarily peaceful ones. Like in the electrical sector, in the nuclear sector, a difference was introduced in terms of what was exclusively reserved for the State—utilizing nuclear energy for the production of energy, but not all possibilities of use of nuclear fuels. With respect to the latter, the constitutional addition practically provided for total regulation, considering that, through the addition published on November 17, 1982, regarding Section X of Article 73 of the constitution, exclusive responsibility was granted to the Congress of the Mexican Union to legislate anything regarding the issue of nuclear energy. It must be clarified that, even in this manner, there is a small difference in terms of

competition, insofar as any use of nuclear fuels for the production of nuclear energy is included under Section X, although the use of the same fuels for something other than the production of energy remains reserved for Congress through the implied powers of the aforementioned Section XXX of Article 73.

¹⁶ Petrochemicals were divided into basic and secondary petrochemicals: the preparation of the first (or basic ones) was exclusively reserved for the State, based on its character as a strategic area, and the secondary ones could be developed by the private sector as long as it held the respective permit. Therefore, the classification was made by the federal executive branch based on administrative resolutions published in the Official Gazette, thereby arbitrarily expanding or limiting the spectrum of action of the State with respect to this activity.

¹⁷ During successive reforms, some of the strategic areas were eliminated, although in no case were there any modifications with respect to the strategic areas of interest to us here.

¹⁸ In terms of the nuclear sector, a monopolistic condition existed for the utilization of nuclear fuels to generate nuclear energy for peaceful purposes as well as control of the organizations or companies participating in such uses.

¹⁹ See <http://pactopormexico.org/como/>.

²⁰ See <http://pactopormexico.org/acuerdos/>.

²¹ The basic reasons for his proposal were the following: “Inclusive access to energy allows countries having natural resources like our country to instill dynamics and competitiveness in its economies to consolidate a model of development that generates sustainable progress for its population. Mexico can not be the exception, and therefore, this initiative of a constitutional reform in energy matters is based on the following strategic elements: (i) Strengthening of the role of the State as the steward of the petroleum industry: provide new tools for the definition and implementation of the energy policy of the country, which allows for adequate and prudent administration of the nation’s petroleum assets. (ii) Economic growth: Mexico is called upon to take advantage of its energy resources in favor of increased investment and the creation of more jobs, based on initiatives that promote the supply of energy in sufficient quantities and at competitive costs. (iii) Inclusive Development: access to energy will make it possible to render the productivity and quality of life of the population in the different regions of the country more democratic. (iv) Energy Security: The availability of primary energy on the national territory must be utilized to achieve continuous, diversified, and economic procurement of the energy supply for this generation and the following generations. (v) Transparency: Guarantee Mexicans proper access to the information regarding administration of the national energy assets. (vi) Sustainability and Environmental Protection: it is possible to mitigate the negative effects the production and consumption of fossil energies may have on health and the environment through increased availability of cleaner sources of

energy. The initiative is presented for consideration by this Sovereignty is based on the basic ideas of the reforms of President Lázaro Cárdenas after the expropriation of the oil industry in 1938, and it must be emphasized that the ownership and the direct control over oil and all solid, liquid, or gaseous hydrocarbons in the subsoil remain and will continue to remain with the Nation. In a similar manner, the ideas that guided the legal reforms by President Lázaro Cárdenas in the electrical industry, which strived for the development of a national electrical system based on technical and economic principles, guided and regulated by the State, are resumed". (D. Penchyna, "Energy reform: history since the Congress," in *Energy reform. The Motor of economic growth and welfare*, eds. A. Gallardo and L. M. de la Mora, (Mexico City, Federal District: Fundación Colosio M.A. Porrúa, 2014), 202.

²² The constitutional reform proposed by the National Action Party was based on the following general considerations: "The energy sector of Mexico has arrived at a crucial point in time. The challenges that arise in terms of the development of hydrocarbons, the supply of electric energy, and the fight against climate change are challenges that break with the paradigms that have dominated the national debate until now. These challenges must be addressed urgently and through decisive actions in terms of structural changes and institutional design, through a comprehensive reform aimed at the goals that must be contemplated in any modern energy policy: security of supply, competitiveness, sustainability, and fiscal viability. In this respect, this present initiative covers three aspects: oil and hydrocarbons, the electrical sector, and a new institutional design in terms of energy matters." See: http://www.pan.senado.gob.mx/wp-content/uploads/2013/07/Inic_PAN_art.25-27-y-28-Const.pdf.

²³ The proposal presented by the PRD had the following considerations and goals: "Subject to the elements stated above, the reform of Articles 27 and 28 of the Constitution proposed this past August 12 by President Enrique Peña Nieto in matters of hydrocarbons is not only contrary to the spirit based on which the Mexican people has built its institutions, but rather also lacks economic, financial, or technical logic in view of the conditions, achievements, and possibilities acquired by the petroleum industry which the Mexican State currently has [...] Here, it is obvious that the initiative is not only a privatization initiative from the point of view of transferring an activity exclusively reserved for the State to private property, but rather, effectively: part of the assets of PEMEX and CFE could be sold in this manner (through listing on a stock exchange). The State, in the best of cases, should share ownership of and control over its assets [...] In the case of Mexico, despite the undoubtable problems the Federal Electricity Commission may have, the public electricity service has been guaranteed and its response, in the event of extreme natural phenomena such as hurricanes or earthquakes, has been proven. The national electric system has furthermore another advantage that is not available in other parts of the world: it is an interconnected system, which makes it possible to offset the costs of different sources of generation and offer the least possible cost and the greatest security for consumers, in particular in case its operator, the CFE, is given the necessary autonomy

to manage its resources. The proposal in matters of hydrocarbons and electricity presented here does not intend to reform the Constitution or transfer resources of the Nation or its income, in particular; it strives to ensure, without any privatization, that Petróleos Mexicanos and the Federal Electricity Commission increase their contribution to national development to trigger investment, industrial development, and job creation.” See <http://www.adnpolitico.com/gobierno/2013/08/19/documento-integro-iniciativa-de-reforma-energetica-del-prd>.

²⁴ They were the laws of Petróleos Mexicanos, the Law Regulating Article 27 of the Mexican Constitution in the Oil Sector, the Federal Fee Act, the Federal Budget and Financial Responsibility Act, the Basic Law of the Federal Public Administration, the Federal Quasi-State Entities Act, the Law of the National Hydrocarbons Commission, the Public Electric Energy Service Act, the Law for Beneficial Use of Renewable Energies and Financing of the Energy Transition, the General Public Debt Act, the Energy Regulating Commission Act, and the Law of Financial Institutions, in addition to establishing the law for the Petroleum Excess Fund.

²⁵ M.A. Bernal, “Energy reform: a negotiation process,” in *Energy reform. The motor of economic growth and welfare*, eds. A. Gallardo and L. M. de la Mora, (Mexico City, Federal District: Fundación Colosio M.A. Porrúa, 2014), 212-217.

²⁶ This Chamber approved the ruling in general with 95 votes in favor by the members of PAN, PRI, and PVEM, and 28 against, in particular with slight variations based on the same votes and identical parties.

²⁷ In general, it was approved with 354 votes in favor by PAN, PRI, and PVEM, 134 votes against by the remainder of the parties represented, and zero abstentions; in particular, with 353 votes in favor, 134 against, and zero abstentions, with the same distribution among parties.

²⁸ Transitional article 20 of the Hydrocarbons Act (published in the Official Gazette on August 11, 2014) established that the comprehensive contracts of exploration and production and financed public works entered into by Pemex would remain in force and effect and that the parties could submit a request to the Ministry of Energy to migrate from an assignment to an exploration and extraction contract without being required to engage in a bidding procedure.

²⁹ As a part of the legislation necessary to implement the constitutional reform in energy matters, the executive branch sent to the Congress of the Mexican Union seven drafts of the decree that involved the enactment or reform of 21 laws. These are the Hydrocarbons Act; the Foreign Investment Act; the Mining Act; the Public-Private Partnership Act; the Law of the Electric Industry; the Geothermal Energy Act; the National Waters Act; the Petróleos Mexicanos Act; the Federal Electricity Commission Act; the Federal Law of

Quasi-State Entities; the Public Sector Purchasing, Lease, and Services Act; the Public Works and Related Services Act; the Law of Coordinated Regulating Bodies in Energy Matters; the Law of the National Agency of Safety, Energy, and Environment in the Hydrocarbon Sector; the Basic Law of the Federal Public Administration; the Hydrocarbons Income Act; the Federal Fee Act; the Fiscal Coordination Act; the Law of the Mexican Oil Fund for Stabilization and Development; the Federal Budget and Financial Responsibility Act; and the General Public Debt Act.

³⁰ In this manner and to promote the participation of national and local productive chains, the bases and minimum percentages of national content in the rules for the performance of assignments and contracts (Article seven); to establish the guidelines and rules of contracts and assignments entered into by the State with productive State companies or with individuals to perform, and on behalf of the Nation, “the activities of exploration and extraction of oil and solid, liquid, and gaseous hydrocarbons” under conditions of maximum transparency (Article nine); to provide for different authorities of different agencies and organizations of the federal public administration (Article six); to specify the conditions under which individuals can contract on behalf of the Nation regarding conditions of financing, installation, maintenance, management, operation, and expansion of infrastructure (Article 11); for the National Hydrocarbons Commission and the Energy Regulatory Commission to be set up as coordinated regulating bodies, with legal personality and technical and management autonomy (Article 12); to establish the conditions for the continuation, removal, and ratification, as the case may be, of the commissioners of the two regulating bodies just mentioned (Article 13); for the establishment of the National Agency of Safety, Energy, and Environment as a decentralized body of the Ministry of Environment and Natural Resources (Article 19); to determine that the productive State companies must create economic value, have budgetary autonomy, and be subject to specific administrative rules, based on coordination with the federal executive branch, and be subject to their own rules in matters of contracts, leases, and biddings, in particular (Article 20), as well as establish comprehensive rules in terms of responsibilities for all public and private subjects who participate in the national energy system (Article 21).

³¹ The Law Regulating Article 27 of the Mexican Constitution in the oil sector established that only the nation could conduct the different exploitations of hydrocarbons making up the petroleum industry and established that the petroleum industry covered: I) the exploration, exploitation, refining, transportation, storage, distribution, and first-hand sale of oil and the products that are obtained through its refining; II) the exploration, exploitation, preparation, and first-hand sale of gas as well as the transportation and storage that are indispensable and necessary to interconnect their exploitation and preparation; and III) the preparation, transportation, storage, distribution, and first-hand sale of derivatives of oil and gas suitable to serve as basic industrial raw materials and which represent basic petrochemicals. In this respect, the participation of social and private sectors was only permitted in activities of transportation, storage, and distribution of gas

and those related with petrochemical products (goods) other than basic ones.

³² In this respect, Article 4 of the Hydrocarbons Act defines exploration as the “activity or set of activities using direct methods, including drilling of wells, aimed at the identification, discovery, and evaluation of hydrocarbons in the subsoil, within a defined area,” and defines extraction as the “activity or set of activities used for the production of hydrocarbons, including the drilling of production wells, injection, and stimulation of deposits; improved recovery; the collection, conditioning, and separation of hydrocarbons; the elimination of water and sediments within the contractual area or the assignment area; as well as the construction, location, operation, use, abandonment, and dismantling of production facilities.

³³ In this regard, the Hydrocarbons Act reproduces this in Article 48, adding that the Ministry of Energy is authorized to grant permits to export and import hydrocarbons and oil, and that the Energy Regulatory Commission is authorized to grant permits for the compression, liquefaction, decompression, regasification, marketing, and retailing to the public of hydrocarbons, oil, or petrochemicals.

³⁴ According to Article 9 of the Hydrocarbons Act, to achieve the subject matter of the assignments that are granted to them by the federal executive branch, the productive State companies will only be able to enter into service agreements with individuals in which consideration is paid in cash. However, the possibility is established for productive State companies to request that the Ministry of Energy migrate such assignments to exploration and extraction contracts, under which they will be able to enter into alliances with legal persons.

³⁵ The most complete presentation can be found in O. Morineau, *Real rights and the subsoil in Mexico*, (Mexico: FCE, 1997), 2nd edition.

³⁶ This same framework applies to contracts entered into by productive State companies with individuals (transitional article four).

³⁷ In this respect, the Hydrocarbons Income Act (published in the Official Gazette on August 11, 2014) establishes the different considerations in favor of the State and the contractor for license agreements (Article six), shared profits (Article 11), shared production (Article 12), and service agreements (Article 21).

³⁸ It is likewise established that the law will specify “the considerations and contributions to be made by the productive State companies or individuals and will regulate cases where payment will be imposed upon them in favor of the nation for the products extracted that are transferred to them.”

³⁹ This is known as *booking of reserve* and means that participating companies will have the option to register the economic interest of investments implied by their hydrocarbon exploration and production schemes.

⁴⁰ It would seem that, after the constitutional reform, *Petróleos Mexicanos* will no longer have any subsidiary agencies, considering that, while transitional articles three and 16 speak of them in past conditions, nothing is said of the same under current conditions. However, the final part of Article 20 expressly provides for the possibility that they will continue to exist or, we believe, that additional ones will be created.

⁴¹ The same article establishes that, in case productive State companies carry out activities of exploration or extraction of oil and other hydrocarbons, the law must establish that the board of directors must be made up by five directors of the federal government, including the secretary of energy (who will act as its chairman and will have the decisive vote) and five independent directors.

⁴² In turn, the *Petróleos Mexicanos Act* (published in the Official Gazette on August 11, 2014) establishes that Pemex is a legal entity established under public law and controlled by the federal government, with its own legal identity and its own assets and technical, operational, and management autonomy and whose purpose is to engage in the strategic activity of the State in the exploration and extraction of oil and solid, liquid, or gaseous hydrocarbons as well as their collection, sale, and marketing, including the transformation, sale, and marketing of its derivatives, through the performance of corporate, economic, industrial, and commercial activities in terms of its subject matter, thereby generating economic value and profitability for the Mexican State as its owner, based on a sense of fairness and social and environmental accountability. Likewise, it has been granted special rules in the following regards: subsidiary and affiliate productive companies, remunerations, contracting, goods, responsibilities, state dividend, budget, and debts.

⁴³ The *Hydrocarbons Act* defines an individual as a “physical or legal person” and a contractor as “*Petróleos Mexicanos*, any other productive State company, or a legal person that enters into, with the National Hydrocarbons Commission, an exploration and extraction contract, whether individually or as a member of a consortium or joint venture, pursuant to the terms of the *Hydrocarbons Income Act*.”

⁴⁴ Some of the constitutional limitations are the aforementioned need to specify, under the contracts, that the oil and all hydrocarbons located in the subsoil are the property of the nation in order to able to report, for accounting and financial purposes, the contract itself and its expected benefits (transitional article five), or that the contracts entered into for exploration or extraction are conducted on behalf of the nation (transitional article nine), which are topics that have a greater impact on the contractual subject matter than on the corporate or organic conditions of the “individuals” who can participate in them.

⁴⁵ We will not dedicate any further considerations to the National Hydrocarbons Information Center, since transitional article 12 only mentions it without incorporating any more detailed requirements or elements to be developed by Congress.

⁴⁶ Other duties include granting approval for the transfer of assignments and authorizing the migration of assignments that are awarded to contracts referred to by Article 27, paragraph seven of the constitutional text (transitional article six).

⁴⁷ These contents have been included in the Hydrocarbons Act and the Law of the Coordinated Regulating Bodies in Energy Matters, both published in the Official Gazette on August 11, 2014.

⁴⁸ Transitional article 12 established that the National Hydrocarbons Commission and the Energy Regulatory Commission needed to be converted into coordinated regulating bodies in this matter, with their own legal personality and technical and management autonomy, authorized to dispose of the revenue resulting from the contributions and uses established by the law for its services in terms of issuing and administrating permits, authorizations, assignments, and contracts.

⁴⁹ The Law of Coordinated Regulating Bodies in Energy Matters provides for the creation of the Coordinating Council of the Energy Sector as the coordinating mechanism between the coordinated regulating bodies, the Ministry of Energy, and the National Natural Gas Control Center (CENAGAS) and National Energy Control Center (CENACE) agencies.

⁵⁰ On August 28, 2014, the decree creating the National Natural Gas Control Center was published in the Official Gazette.

⁵¹ These contents were included under the Law of the National Agency for Safety, Energy, and the Environment (published in the Official Gazette on August 11, 2014).

⁵² In the same precept, it was established that the Mexican Oil Fund for Stabilization and Development would remain subject to the duties in matters of transparency as set forth by law. It also established that the information that makes it possible to track the financial results of the assignments and contracts referred to by Paragraph Seven of Article 27 of the Constitution as well as the spending by the Mexican State should be published electronically.

⁵³ Likewise, it was established that, as long as the balance of investments in long-term public savings is equal to or higher than 3 percent of the gross domestic product of the year prior to the one in question, the Technical Fund Committee could use the resources of the cumulative balance of the fund for other purposes.

⁵⁴ It should be pointed out that one of the consequences of the qualification of strategic areas was updated in transitional article eight. Because of its importance, its two first

paragraphs will be transcribed below: “Based on their strategic character, activities of exploration and extraction of oil and other hydrocarbons as well as the public service of transmission and distribution of electric energy referred to by this present decree are considered to be of social interest and public order, and therefore, they will have priority over any other ones that involve the utilization of the surface and subsoil of the lands related therewith. The law will establish the general terms and conditions of the consideration that must be paid for surface occupation or use or, as the case may be, the respective indemnity.”

⁵⁵ The Law of the Public Electric Energy Service (repealed) established that the provision of the public service of electric energy comprised the following: I) the planning of the national electric system; II) the generation, conduction, transformation, distribution, and sale of electric energy, and III) the performance of all works, facilities, and work that requires planning, performance, operation, and maintenance of the national electric system. Likewise, it indicated any activities not considered public service and which, therefore, could be performed by individuals after having obtained a permit from the Energy Regulatory Commission. These activities include: I) the generation of electric energy for self-supply, cogeneration, or small production; II) the generation of electric energy by independent producers for sale to the Federal Electricity Commission; III) the generation of electric energy for export, as a result of cogeneration, independent production, or small production; IV) the import of electric energy by individuals or legal persons intended for supplying their own uses; and V) the generation of electric energy intended for use in emergencies as a result of interruptions in the public electric energy service.

⁵⁶ These contents were incorporated under the Law of the Federal Electricity Commission (published in the Official Gazette on August 11, 2014).

⁵⁷ Unlike what happened with the Hydrocarbons Act, the Electrical Industry Act (published in the Official Gazette on August 11, 2014) does not define the concepts of individual or contractor.

⁵⁸ On August 28, 2014, the decree creating the National Energy Control Center was published in the Official Gazette.

⁵⁹ It was also established that the center should provide whatever necessary to ensure that the Federal Electricity Commission transfer the resources required by the National Energy Control Center to comply with its functions.

⁶⁰ Based on our analysis of the content of the reforms, insofar as productive State companies and the bodies of the public administration are concerned, let’s not forget that, according to paragraph four of Article 25 of the constitutional text, the State must maintain control over and ownership of both of them.