

Power and Hydrocarbons Sectors Law Bills

Mexico City, February 10, 2025

NEW LAWS PROPOSED FOR THE ENERGY SECTOR

On February 4, 2025 a bill containing the draft decree for the issuance of a set of laws for a new legal framework in the energy industry was submitted before the Senate¹ (the “Bill”), which aims to implement the reform to Articles 25, 27, and 28 of the Political Constitution of the United Mexican States, which took effect on November 1st, 2024.²

The recent constitutional reform in energy matters creates a new model for the energy industry where the Mexican State retains a significant role, with a more social profile, maintaining control and planning of the system, while also creating opportunities for the private sector in certain activities of the industry (generation and commercialization of electricity, exploration and extraction of hydrocarbons, commercialization, transportation, storage, and distribution of hydrocarbons, petroleum products, and petrochemicals, among others). In addition, it establishes rules for the development of mixed projects between state-owned companies and private entities.

The Initiative includes the issuance or modifications to the following laws:

1. Six new main laws:
 - a. Energy Planning and Transition Law
 - b. Electric Sector Law
 - c. Public State Company Law – *Comisión Federal de Electricidad*
 - d. Hydrocarbons Sector Law
 - e. Public State Company Law – *Petróleos Mexicanos*
 - f. National Energy Commission Law

¹ https://www.senado.gob.mx/66/gaceta_del_senado/documento/147031.

² <https://www.galicia.com.mx/links/publicacion?p=932>.

2. Two new complementary laws:

- a. Biofuels Law
- b. Geothermal Law

3. Reform of certain provisions in three complementary laws:

- a. Hydrocarbons Sector Revenues Law
- b. Mexican Petroleum Fund for Stabilization and Development Law
- c. Organic Law of the Federal Public Administration

Due to its relevance, we include in this alert the executive summary and a link to our analysis of the initiatives related to the Power Sector Law ("LSE") and the Hydrocarbons Sector Law ("LSH"). We will later share summaries and analyses regarding the remaining new laws and the modifications to existing laws.

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POWER SECTOR LAW
EXECUTIVE SUMMARY

- **Strategic activities reserved to the State.** The bill confirms that the planning and control of the SEN, as well as the transmission and distribution of electricity, are strategic areas reserved for the Mexican State. The control and planning of the SEN will be the responsibility of the Ministry of Energy ("SENER"), with binding authority, following principles of reliability, continuity, and accessibility of the public electricity service, aiming, among other things, to promote electricity supply to the population at the lowest possible price, foster the energy transition, and expand and decarbonize the sector to meet SEN demand. The transmission and distribution of electricity, as well as the basic supply, will be exclusively assigned to the Federal Electricity Commission ("CFE").
- **Prevalence of the Mexican State.** CFE, as a public entity of the State, will have prevalence in generating at least 54% of the electricity injected into the SEN during each calendar year.
- **Participation of Private Entities.** Subject to CFE's prevalence, electricity generation and commercialization will operate under a competitive regime in which both the Mexican State and private entities may participate, either individually or jointly with the State, in any of the following modalities:

- ✓ **Distributed Generation.** Up to 0.7 MW of capacity, without requiring a permit.
 - ✓ **Self-supply.** Isolated or interconnected to the SEN, starting from 0.7 MW, with no capacity limit.
 - ✓ **Wholesale Electricity Market.** Starting from 0.7 MW, with no capacity limit.
 - ✓ **Mixed Development**
 - Long-term contracts for sales to CFE, with no capacity limit.
 - Mixed investment, with at least 54% participation by CFE.
 - ✓ **Cogeneration.** No capacity requirement, subject to new rules that may reduce its operational efficiency.
- **Authorities and Entities in the Energy Sector**
- ✓ **National Energy Commission ("CNE").** A new decentralized regulatory body replacing the Energy Regulatory Commission ("CRE") and the National Hydrocarbons Commission ("CNH").
 - ✓ **SENER.** Responsible for the country's energy policy, with broad powers, some of which overlap with those of the CNE, potentially creating uncertainty regarding government actions.
 - ✓ **CFE.** A public entity of the State, with a social function. It will be consolidated into a single entity that integrates all its subsidiaries and some affiliates, subject to operational separation rules, especially concerning its participation in the Wholesale Electricity Market ("MEM").
 - ✓ **National Center for Energy Control ("CENACE").** Maintains its status as a decentralized public entity responsible for the operation of the SEN.
- **Power Supply.** Power supply is a public interest service and can be provided in three different modalities:
- ✓ **Basic Supply.** Exclusively provided by CFE for the benefit of non-qualified users, subject to a tariff regime.
 - ✓ **Qualified Supply.** Provided by CFE or private entities to users requiring more than 1 MW of capacity (Qualified Users).
 - ✓ **Last-Resort Supply.** Offered by a permit holder to Qualified Users for a limited time to ensure service continuity.
- **"Grandfathered" Regime.** The continuity of permits, contracts, and other administrative acts granted or executed under the Public Electricity Service Law ("LSPEE") and the LIE is recognized and respected.

In this link, you will find a summary and a more detailed and comprehensive analysis of the LSE: https://www.galicia.com.mx/links/en_publicacion?p=985.

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HYDROCARBONS SECTOR LAW

EXECUTIVE SUMMARY

- **Planning and control by the Mexican State.** The regulation, planning and supervision of the hydrocarbons sector will be the responsibility of the Ministry of Energy ("SENER"), based on the promotion of energy justice, sustainability, energy sovereignty and security, and the encouragement of the sector for its expansion and modernization.
- **Priority role of PEMEX.** The LSH bill includes the priority role that PEMEX would have in the complete hydrocarbons value chain. In the upstream sector, PEMEX will have the power to determine the type or mode of entitlements (*asignaciones*) for the development of blocks, being able to decide to use mixed schemes with the help of private participants in case it is required due to its technical, operative, financial or execution needs, for which it will require the authorization of SENER. With respect to midstream and downstream, all asymmetric and first-hand sales regulations applicable to PEMEX would be repealed, and PEMEX would be expressly exempted from open access obligations for transportation, storage and distribution of hydrocarbons, petroleum products and petrochemicals, as well as from cross participation restrictions.

The elimination of the open access obligation for PEMEX would have a significantly serious effect on its potential users of the hydrocarbon transportation service, since PEMEX could be allowed to deny the service without providing a reason for such denial, leaving potential users with alternative means. The open access obligation considers (among others) the monopolistic nature of the pipelines along their route, where they are sometimes the only option for a user to receive products.

- **Participation modes.** The SENER may grant, in order of priority and subject to the prevalence of PEMEX, entitlements or contracts under three schemes: (i) entitlements for PEMEX' own development; (ii) entitlements for mixed development, together with a private participant; and (iii) exploration and extraction contracts. Private industry participants will have the opportunity to participate in options (ii) and (iii), with (iii) being an exceptional scenario and subject to the issuance of new guidelines to regulate the bidding procedures.

- **Redefining participating authorities**
 - ✓ **National Energy Commission (*Comisión Nacional de Energía, "CNE"*)**. A new decentralized regulatory body replacing the National Hydrocarbons Commission ("CNH") and the Energy Regulatory Commission ("CRE"), inheriting a number of their functions.
 - ✓ **SENER**. Responsible for the country's energy policy and counterpart in the exploration and extraction contracts (replacing CNH), with broad powers regarding exploration, extraction, import and export of hydrocarbons and their derivatives. Some of these powers are confusing or overlap with those of the CNE, which could lead to uncertainty regarding governmental actions and authority.
 - ✓ **National Center for Natural Gas Control (*Centro Nacional de Control de Gas Natural, "CENACE"*)**. Maintained as a decentralized public agency, whose purpose is to act as operator and independent manager of the Integrated National Natural Gas Transportation and Storage System ("SISTRANGAS").
 - ✓ **Safety, Energy and Environment Agency (*Agencia de Seguridad, Energía y Ambiente, "ASEA"*)**. It is maintained as the body responsible for issuing the regulations and standards applicable to industrial and operational safety, as well as environmental protection, in the hydrocarbons sector.

- **Updating of the terms of activities subject to a Permit**. The LSH bill updates the activities that are considered as permitted activities, through the introduction of new defined terms or the clarification of those originally contained in the LH, namely: (i) the activity of "commercialization" is now a defined term; (ii) a permitted activity of "formulation" is created, applicable to the blending of petroleum products, including the incorporation of additives; (iii) export and import activities of hydrocarbons, petroleum products and petrochemicals are subject to permit from SENER, adding a joint and several liability in tax matters for importers in those regulated activities associated with imports; (iv) it is clarified that the activity of collection/gathering will not be considered within the regulated activity of transportation; (v) it is clarified that treatment includes industrial processes inside or outside the contractual or entitlement area; (vi) transloading (*trasvase*) may only be carried out as an accessory activity of the permitted activities (transportation/distribution) and in the facilities authorized in the corresponding permits; and (vii) PEMEX will have priority in transportation and storage capacity of new integrated systems, being considered of public interest.

- **Modifications to procedures and requirements for obtaining permits and authorizations**. The LSH bill contains modifications to the procedures for obtaining

permits and authorizations, including additional requirements for some activities (i.e., creation of a social impact statement, obligation to have volumetric controls, analysis of a healthy development of the market, alignment with binding criteria) and changes (i.e., the modification of the capital stock of a permit holder that implies a corporate or management change, will require updating of the relevant permit).

- **Changes in verification authority, sanctions and penalties.** The LSH bill strengthens the verification powers of SENER, CNE and other authorities. It includes a greater reporting burden on regulated activities, including volumetric controls, and broader verification powers and for various matters, including investigations for “*huachicol*” and “*huachicol fiscal*” (fuels theft as well as related tax evasion). Information shared with the authorities shall not be subject to commercial, banking, tax or fiduciary secrets.

In addition, the LSH bill contains adjustments to penalties, mainly increasing the amounts of fines for non-compliance from 30% to 50% of the amounts previously considered in the LH. Uncommon in Mexican law, it also includes the analysis of indirect damages for the calculation of penalties. The size of the penalties could become actual impediments to attract private investment in the hydrocarbons sector.

- **Transitory articles.** The LSH bill contains important provisions in the transitory articles. In this regard, we highlight the following:
 - ✓ Entitlements and contracts granted or entered into prior to the entry into force of the LSH, including agreements for access to information entered into with the National Hydrocarbons Information Center (“CNIH”), will remain in full force.
 - ✓ SENER will have 180 days to execute amendment agreements to the exploration and extraction contracts executed by PEMEX -either individually or in consortium-, in order to recognize the latter’s change in its legal nature.
 - ✓ Permits and authorizations granted by SENER, CNH or CRE prior to the entry into force of the LSH, will remain in force and will be maintained under the same terms and conditions under which they were granted.
 - ✓ Requests for authorization, approval or permits received prior to the entry into force of the LSH will be processed in accordance with the legal provisions in effect at the date of their submission.
 - ✓ The commencement of the obligation to obtain permits for the formulation of refined products will be subject to the issuance of the corresponding official Mexican standards.

- ✓ Social impact evaluations that have been issued prior to the entry into force of the LSH will continue to be in force until the provisions corresponding to the new social impact assessment for the energy sector are issued.
- ✓ The administrative provisions regarding contract bidding are repealed and all bidding rules for the awarding exploration and extraction contracts are null and void, with the understanding that new guidelines will be issued for bids under the LSH.
- ✓ No provision related to national content obligations is included.
- ✓ A transitory regime is included where SENER is empowered to determine the quality specifications applicable to petroleum products, including access obligations for taking samples and sending the results to the CNE.

In this link, you will find a summary and a more detailed and comprehensive analysis of the LSH: https://www.galicia.com.mx/links/en_publicacion?p=986.

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