

# **MEXICAN HYDROCARBONS LAW REFORM: MINIMUM STORAGE, REVOCATION, AND SUSPENSION OF PERMITS**

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## **I. Introduction**

In December 2013, a series of legal reforms known as the “Energy Reform” were implemented in Mexico. These reforms implied an opening of the oil and gas and electric power sectors to private investment. In 2018, Andrés Manuel López Obrador was elected President of Mexico as he declared his intention to benefit State-owned companies Petróleos Mexicanos (PEMEX) and the Federal Electricity Commission (the CFE) over private companies. One example of such statements was the following declaration given by the current Mexican president on October 24, 2020:<sup>1</sup>

“We are going, according to the legal framework, to give preference to both the Federal Electricity Commission and PEMEX, as clear as that, which are state-owned companies.”<sup>2</sup>

On January 11, 2021, the U.S. Secretaries of State, Energy, and Commerce sent a letter to Mexico’s Secretaries of Foreign Affairs, Energy and Economy, sharing their concern regarding “recent regulatory actions by the Mexican government.” The following statement is particularly remarkable:

“(…) as we have discussed with you previously, recent regulatory actions by the Mexican government have created significant uncertainty about Mexico’s overall investment climate. Most recently, we have been concerned by reports of a July 22, memo, followed by a September 22 meeting with regulators who were allegedly instructed to block permits for private sector energy projects and to exercise their regulatory authority to favor state-owned energy companies.”<sup>3</sup>

From 2018 to date, the Mexican government has been criticized for its energy policy, particularly with respect to the electricity sector. Very recently, however, a new reform caused concern among the midstream and downstream oil and gas sectors.

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<sup>1</sup> See: <https://youtu.be/CD-L-s-YzZ8>

<sup>2</sup> “*Vamos, de acuerdo a los márgenes legales que se tengan, a darle preferencia tanto a la Comisión Federal de Electricidad como a PEMEX, así de claro, que son empresas públicas.*”

<sup>3</sup> See in: <http://manuelcardenasfonseca.mx/us-mexico-letter/>

On March 26, 2021, a draft legislative reform sent by the Mexican President to reform the Hydrocarbons Law (the Draft)<sup>4</sup> was published in the Parliamentary Gazette of the Chamber of Deputies. The Draft was approved, and on May 4, 2021, was published in the Official Gazette of the Federation (the Reform).<sup>5</sup>

The Mexican President emphasized in the statement of legislative reasons of the Draft the importance of energy security and sovereignty. He said that the Draft seeks to discourage various practices related to the illicit trade of hydrocarbons and petroleum products, and to reorganize various economic activities in the energy sector to fight corruption, guarantee supply, and protect the national economy and the income received by Mexico. Some have labeled the Reform unconstitutional.

The Reform addresses the following issues: (i) minimum storage of petroleum products; (ii) acceptance by inaction of the permit processing procedure; (iii) revocation of permits; (iv) fuel trafficking; and (iv) suspension of permits due to imminent danger to national security, energy security, or the national economy.

## **II. Minimum Storage of Petroleum Products**

The Reform added section III to Article 51 of the Hydrocarbons Law. With this addition, the granting of the following permits is subject to the interested party having sufficient storage capacity determined by the Ministry of Energy (the SENER): the treatment and refining of oil; the processing of natural gas; the export and import of hydrocarbons and petroleum products granted by SENER; the transportation, storage, distribution, compression, liquefaction, decompression, regasification, commercialization, and sale to the public of hydrocarbons, petroleum products, or petrochemicals; and the management of integrated systems, issued by the Energy Regulatory Commission (the CRE).

The industry was particularly worried by Article Fourth Transitory of the Reform that establishes that the competent authority would revoke permits in place as of the effective date of the Reform that do not comply with the storage requirement determined by the SENER.

## **III. Acceptance by Inaction of the Permit Processing Procedure**

Article 53 of the Hydrocarbons Law also was amended. The former article established that the requests for assignment processed before the SENER or the CRE had to be resolved within the 90 days, and in the absence of a response, the request was to be

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<sup>4</sup> Initiative of the Federal Executive with draft decree, by which various provisions of the Hydrocarbons Law are amended and added, *Gaceta Parlamentaria de la Cámara de Diputados*, Year XXIV, Number 5747-I, March 26, 2021. See in:

<http://gaceta.diputados.gob.mx/PDF/64/2021/mar/20210326-I.pdf>

<sup>5</sup> Official Gazette of the Federation, *Decreto por el que se reforman y adicionan diversas disposiciones de la Ley de Hidrocarburos*, May 4, 2021. See in:

[http://dof.gob.mx/nota\\_detalle.php?codigo=5617453&fecha=04/05/2021&print=true](http://dof.gob.mx/nota_detalle.php?codigo=5617453&fecha=04/05/2021&print=true)

considered as granted (acceptance by inaction). With the Reform, however, the lack of response is now understood as a refusal (refusal by inaction).

#### **IV. Revocation of Permits**

Article 56 of the Hydrocarbons Law establishes that, for very specific causes, SENER and CRE may revoke permits. The Reform added the following causes for revocation:

- Carrying out activities of transportation, storage, distribution or sale to the public of hydrocarbons, petroleum products or petrochemicals, proven to have been acquired by the commission of the crime of smuggling of hydrocarbons, petroleum products and petrochemicals, and which have been so determined by a final resolution of a competent authority.
- Reoffending in:
  - Failure to comply with the provisions applicable to the quantity, quality and measurement of hydrocarbons and petroleum products.
  - Modification of the technical conditions of systems, pipelines, facilities or equipment without the corresponding authorization.

In addition, the Article Sixth Transitory of the Reform establishes that, upon its entry into force, permits where it is proven that their holders do not comply with the corresponding requirements or that violate the provisions of the Hydrocarbons Law must be revoked.

The President stated in the Statement of Reasons that the Reform seeks to combat retailers who purchase stolen fuels at a lower price than they would pay for fuels of legal origin, affecting the industry and the Mexican Treasury.

#### **V. Fuel Trafficking**

The Reform amends Article 86 of the Hydrocarbons Law so that a permit will be revoked in case of recidivism in:

- Failure to comply with the provisions applicable to the quantity, quality and measurement of hydrocarbons and petroleum products.
- Modification of the technical conditions of systems, pipelines, facilities or equipment without the corresponding authorization.

The President mentioned in the Statement of Reasons that the Reform intends to empower the SENER and the CRE to revoke permits when it has been determined by a

final resolution of the competent authority that the permit holders have committed the crime of smuggling of hydrocarbons, petroleum products, or petrochemicals.

Some consider this part of the Reform to contemplate new causes for revocation of permits that were not established at the time investments were made.

## **VI. Suspension of Permits Due to Imminent Danger to National Security, Energy Security, or the National Economy**

The Reform adds in Article 57 the possibility that permits may be suspended to protect the country's interest. Article 59 Bis was also added, providing that the SENER and the CRE may suspend permits when an imminent danger to national security, energy security, or the national economy is foreseen. This provision has raised concerns because of the ambiguity of the standard.

Article 59 Bis also provides that, if a permit is suspended, the authority will oversee the administration and operation of the permit to guarantee the interests of the end users and consumers. It is unknown if the suspended operator will receive any compensation due to the use of its facilities by the State.

The Reform states that the suspension will have the duration determined by the authority, and the permittee may request the termination of the suspension when it demonstrates that the causes that caused the suspension have been remedied or have disappeared, if the cause does not originate from an illegal act in the commercialization or transportation or alteration of the fuel components.

Finally, the Reform provides that, if after the term of the suspension the permittee is not able to continue with its obligations, the authority will proceed to revoke the permit altogether. Such an action might be considered an indirect expropriation in an investment arbitration proceeding. Although Article Third Transitory of the Reform establishes that all permit holders that could be affected in their legal sphere and rights may claim damages, this article does not expressly refer to the issue of suspension.

The suspension provisions of the Reform leave seem to allow arbitrary and indefinite suspensions in which issues of compensation, the payment of consideration for the use of facilities, or the payment to the permit holder's workers, is not very clear. In addition, it has been criticized for the lack of clarity around the broad concepts of "national security, energy security or national economy."

## **VII. Suspension of the Reform**

On May 6, 2021, various companies filed an *amparo* recourse claiming to be affected by the Reform. The companies demanded its suspension until a ruling is made on its constitutionality. They also demanded that the CRE not revoke the companies' permits for noncompliance with the minimum fuel storage capacity and not to suspend their permits "when imminent danger to national security, energy security or the national economy is

foreseen” due to imprecise hypotheses. On May 7, 2021, the provisional suspension was granted.<sup>6</sup>

Later, on May 16, 2021, a Decree was issued ordering the following:

- First, not to grant the interim measure of suspension with respect to Articles 56, 59 Bis and 86 of the Hydrocarbons Law, given that the effects and consequences are of future and uncertain qualities.
- Second, pending the *amparo* resolution, to suspend Articles 51, 53 and 57 of the Hydrocarbons Law, as well as the Fourth and Sixth Transitory Articles of the Reform, because they establish: (i) additional requirements for obtaining any of the permits contemplated in Title Three of the Hydrocarbons Law; (ii) modify the rules that operate for the resolution of applications for the assignment of permits; (iii) contemplate a restriction for private companies to participate in the management and control of occupied, intervened or suspended facilities; and (iv) contemplate new causes for revocation of permits, whose application is not conditioned, in principle, to the updating or performance of any subsequent act, which reveals that their application could be imminent.<sup>7</sup>
- Third, that the suspension has effects not only on those who requested the injunction, but also on all permit holders in the hydrocarbons, petroleum products and petrochemical markets.

## Conclusion

Due to Mexico’s state policy regarding the electricity sector, the international community has been wondering whether the behavior of the Mexican state could lead to a wave of investment arbitration proceedings. Now, the oil and gas sector is also concerned and wonders whether the Reform is the first of several actions to come, and whether the suspension of the Reform will motivate the Mexican president to formulate a constitutional reform to achieve its goal to benefit PEMEX and CFE at the expense of private companies.

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<sup>6</sup> Second District Court in Administrative Matters, Specialized in Economic Competition, Broadcasting, and Telecommunications, suspension incident 940/2021, May 10, 2021.

<sup>7</sup> *Íbidem*, May 16, 2021.