

# Energy Reform Approved by the Mexican Congress

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*This GT Alert describes the most important aspects of the Energy Reform approved on December 12, 2013 by the Mexican Congress amending Articles 25, 27 and 28 of the Mexican Constitution (the "2013 Energy Reform").*

## 1. Background

The energy reform enacted on November 2008 gave **Petroleos Mexicanos** ("PEMEX") more flexibility in government procurement and allowed incentives for service contracts based on the performance of the contractor and a payment of a rate per barrel.

The 2008 reform created the **National Hydrocarbons Commission** ("CNH") as the regulatory agency of the E&P upstream activities.

However, the 2008 reform failed to align the interests of PEMEX and the contractors to increase production and cost reduction. The 2013 Energy Reform seeks to fully transform the energy sector, including hydrocarbons and electricity.

For the drafting of the Energy Reform the following were taken into consideration:

1. The energy reform proposals submitted by: PRI (Federal Executive) on 14 August, 2013, PAN on 31 July, 2013 and PRD on 20 August 2013.
2. The discussions and public forums wherein members of the civil society, professors, researchers, representatives of agencies of the Federal Public Administration, and other specialized agencies, etc. exchanged views and opinions.

## 2. 2013 Energy Reform

Described below are the main highlights of the 2013 Energy Reform:

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## A. Hydrocarbons

1. The Federal Government has the authority to carry out exploration and production activities of hydrocarbons through leases to Productive State Companies<sup>1</sup> ("EPE") or through contracts with such EPEs or with private parties. PEMEX has two years from the 2013 Energy Reform publication date, in order to transform into an EPE.
2. Investment by private parties in E&P activities is allowed; however, the mineral rights shall not be transferred to private parties, domestic or foreign, while the minerals have not been yet extracted.
3. The contractual regime for upstream activities will include, among others: license agreements, production sharing contracts, profit sharing agreements and services agreements. Congress shall issue, within four months from the publication date of the Energy Reform, the amendments to the legal framework to conform said contractual regime.
4. The Energy Ministry ("SENER") shall be responsible for:
  1. Awarding of Oil & Gas leases to the EPEs.
  2. Selection of contractual areas.
  3. Technical design of the upstream contracts.
  4. Issuing technical guidelines for the bidding processes.
  5. Grant permits for the refining and treatment of oil and processing of natural gas.
5. CNH shall be responsible for the following:
  1. E&P regulation.
  2. Provide technical advice to SENER.
  3. Compile geological and operational information.
  4. Authorize seismic survey and prospecting.
  5. Conduct bidding processes and manage awards to private parties for E&P activities.
  6. Supervise production plans to maximize productivity.
6. The Ministry of Finance ("SHCP") shall be responsible for establishing the fiscal aspects of the bidding processes and contracts in connection with the government take.
7. The Mexican Petroleum Fund for the Stabilization and Development ("FMP") shall be created

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as a public trust fund with the Central Bank of Mexico as trustee, for the purpose of managing oil revenues. The corresponding taxes will fall outside the mandate of the FMP.

8. The National Natural Gas Control Center ("CENAGAS") will be established as a decentralized government entity in order to operate the national pipeline system for the transportation and storage of natural gas.
9. The CNH and the Energy Regulatory Commission ("CRE") shall be independent government regulatory agencies with technical, operational and certain budgetary autonomy.
10. CRE shall have authority to regulate the granting of permits related to the storage, transportation and distribution of oil, gas, refined products and petrochemicals by pipelines. CRE shall also regulate the access of third parties to the transportation pipelines and storage facilities of hydrocarbons and their by-products, as well as their first hand sales.
11. The National Agency for Industrial Safety and Environmental Protection is a new agency independent of the Ministry of Environment and Natural Resources ("SEMARNAT"), whose objective is to regulate and supervise industrial, operational safety and environmental protection (HSE).
12. Private parties may book, for financial and accounting purposes, the expected benefits from the reserves based on the corresponding lease (if in a JV with PEMEX) or contract.
13. PEMEX shall have an initial period to choose the fields for E&P activities (round zero). The scope shall be determined by the CNH once PEMEX demonstrates that it has the technical, financial and execution capabilities. PEMEX shall have three months from the publication of the 2013 Energy Reform in order to submit its request to SENER.
14. Congress shall make adjustments to the legal framework to improve transparency in the Oil & Gas sector.
15. The seats for the members of the Union shall be removed from the Board of Directors in PEMEX.

## **B. Electricity**

1. The 2013 Energy Reform opens the generation of electricity for public service to private parties and establishes the express constitutional prohibition on granting concessions to private parties for wheeling and distribution of electricity, as well as for planning and operational control of the National Electricity System ("SEN"). Therefore, these four activities remain as exclusive areas for the Mexican state.
2. Congress shall issue, within four months from the publication date of the Energy Reform, the legal provisions to regulate the contracting regime for private parties to participate in the construction, maintenance and operation of electrical grids.
3. The National Energy Control Center ("CENACE") is transformed from a subdivision of Federal Electricity Commission ("CFE") into a decentralized government entity in order to exercise operational control of the SEN and the wholesale market. Thus, granting more

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autonomy to the entity dispatching electricity.

4. The CRE shall have authority to grant permits for electricity generation, as well as to regulate and establish the wheeling and distribution rates.
5. Congress shall issue, within four months from the publication date of the Energy Reform, a new law to regulate the survey, exploration and production of geothermal resources.
6. The seats for the members of the Union shall be removed from the Board of Directors in CFE.

### **3. Conclusions**

1. This 2013 Energy Reform will provide greater legal certainty and transparency to the energy sector.
2. It will open up the sector to private investment, create jobs, better technologies, training and best industry practices, especially in deep water and unconventional plays.
3. It will modernize public companies in the energy sector by opening certain activities to competition.
4. It will enable Mexico to take advantage of the high prices of crude oil to increase oil revenues, and allow Mexican companies the use of cheaper fuels to be more competitive in their manufacturing and export activities.
5. Congress shall, within one year after the publication of the 2013 Energy Reform, adjust the legal framework in order to establish the guidelines for the protection of the environment in all activities involving participation from private parties and EPEs.
6. Congress shall, within four months after the publication of the 2013 Energy Reform, adjust the legal framework in order to establish greater anticorruption control mechanisms.
7. One of the most significant challenges is the migration of the current executed contracts with PEMEX E&P to the new legal framework.
8. The distinction between basic petrochemicals and secondary petrochemicals is eliminated.

It should be taken into consideration that upon approval today by the Mexican Congress, the Energy Reform will be sent to the State Legislatures of Mexico for approval.

The Energy Reform may be published in the Federal Official Gazette in January 2014.

Finally, the Energy Reform, including the new laws and amendments to the legal framework including the enactment of the corresponding regulations, is expected to be fully implemented by 2015.

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<sup>1</sup>The Productive State Companies shall have as their objective the creation of economic value with social and environmental responsibilities. Said companies will have an organization based on the best international practices, ensuring their technical, managerial, budgetary, operational and

contractual autonomy. —

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