

On February 4, 2025, a bill containing the draft decree for the issuance of the new Hydrocarbons Sector Law (the "LSH") was presented by the Executive Branch to the Senate. If approved, as expected, the LSH will come into effect the day after its publication in the Federal Official Gazette of the Federation, repealing and replacing the Hydrocarbons Law (the "LH"), which has been in force since August 2014.

The LSH bill aims to implement the reform to Articles 25, 27, and 28 of the Mexican Constitution of the United Mexican States, which took effect on November 1st, 2024.¹ The LSH bill maintained a similar structure than the LH, adjusting the content as necessary to achieve its objectives.

In general, the LSH bill reflects a restructuring of the hydrocarbons industry in which the Mexican State is actively and deeply involved in the different schemes proposed for the exploration and extraction of hydrocarbons, including different modes in which private parties may have the possibility to actively participate. This bill seeks to prioritize the development of the national hydrocarbons industry through *Petróleos Mexicanos* ("PEMEX"), improve the traceability of hydrocarbons and petroleum products, and restructure the mixed investment schemes, highlighting the effort to recover energy sovereignty. The State will have a more favorable treatment or priority compared to private parties in the participation in the different activities of the industry. Regarding exploration and extraction activities, private parties will have a complementary role.

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.

¹ <https://www.galicia.com.mx/links/publicacion?p=932>.

- **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, "CENAGAS"*).** 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 (*travase*) 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.

Below our analysis of the impact of the LSH bill, segmented by industry sectors.

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A. Upstream

For exploration and extraction activities, the LSH bill generally maintains the modes originally contained in the LH: (i) entitlements, and (ii) exploration and extraction contracts (“CEE”). However, the LSH bill includes provisions regarding the order of precedence in granting these, giving priority to PEMEX’s interest in the development of the areas.

The proposed modalities in the initiative are as follows:

- ✓ **Entitlements for own development.** Areas owned by the State would generally be granted as entitlements to PEMEX on a priority and exclusive basis, allowing the public company to develop exploration and extraction in these areas.

These entitlements may later be replaced by entitlements for mixed development if PEMEX requires additional technical or financial capabilities for their development, subject to approval by PEMEX’ board of directors and authorization by SENER.

- ✓ **Entitlements for mixed development.** If PEMEX requires technical, operational, or financial support to develop these fields, it may request SENER to grant entitlement for the mixed execution of exploration and extraction activities.

In such cases, one or more private participants may join PEMEX in a partnership. To this end, SENER would grant the entitlement exclusively to PEMEX, and then PEMEX would enter into a mixed contract with the private participants complying with the minimum requirements of the LSH. These mixed contracts would be similar to what is known in the industry as “farm-out” agreements.

Some key points for this type of entitlements include: (i) PEMEX’ minimum participation interest in these cases will be 40%; (ii) PEMEX will not be required to make financial contributions, although it is unclear whether it will have the right to do so in certain cases; (iii) any party may act as the oil operator, which by definition includes responsibility for all activities, work, and administrative management; (iv) PEMEX’ participation is non-renounceable; (v) participants selection will be carried out by PEMEX; (vi) any amendment require SENER and PEMEX’ consent; (vii) once taxes under the Hydrocarbons Income Law and costs are paid, parties would distribute revenues according to their interest percentage;

and (viii) cost recovery cannot exceed 30% of the revenues or, unless approved by SENER and PEMEX' board, a maximum of 40%.

It is worth noting that the Ministry of Finance (*Secretaría de Hacienda y Crédito Público*) has been included as an authority, alongside SENER, to review cost recovery and accounting related to the compliance with activities under this modality. This measure should provide a more balanced and accurate scenario for both private entities involved in mixed contracts with PEMEX and the public company itself.

- ✓ **Exploration and Extraction Contracts (CEE).** Exceptionally, and with express consent from PEMEX' board, SENER may tender CEEs. The different types of CEEs remain as originally considered in the LH (i.e., services, shared profit, shared production, or license agreements).

Disputes arising from CEEs remain subject to alternative dispute resolution mechanisms. Administrative rescission remains a non-arbitrable procedure. Under no circumstances can the parties be subjected to foreign laws.

It is important to mention that the determination of having the State-owned company prevailing over private entities, could give rise to claims under international treaties, including the USMCA, which prohibits granting unjustified advantages to state-owned companies over other industry participants from investor States.

Additionally, it is relevant to note that, in the three aforementioned modes, the return of areas to the State for relinquishment is subject to a new qualification: that the area be returned is in "good condition". This opens the door to arbitrary interpretation and lack of certainty. The respective regulation should clearly define this concept.

The bill does not include provisions for private entities regarding the booking of reserves. This omission could become an obstacle for investors in the upstream sector that are listed on the stock exchanges.

B. Midstream and downstream

For midstream and downstream activities, several significant changes are incorporated compared to the LH. Among others, the bill includes the following:

- ✓ Defined term for “commercialization” activity, referring to the offering the sale of hydrocarbons, petroleum products, or petrochemicals within national territory, including the possibility of managing or contracting services for transportation, storage, or distribution of these products or other value-added services. The LSH regulations and administrative provisions are expected to detail the terms and conditions of the commercialization permit.
- ✓ A permitted activity of “blending” (*formulación*) was created. This refers to the blending of refined products with additives and biofuels, subject to relevant quality specifications. Permits will specify which products are allowed for blending and the process flow involved. The LSH regulations and administrative provisions are expected to provide further details.
- ✓ The LSH includes the regulation for obtaining export and import permits from SENER, determining potential tax liabilities for importers in any activity related to the import of the corresponding product.
- ✓ Transloading (*trasvase*) is considered as an accessory activity to the permits of transport and distribution, and may only be performed within the facilities approved under the corresponding permits.
- ✓ Integrated systems may include transportation through means other than pipelines. SENER is the competent authority for approving the creation of integrated systems and determining new infrastructure, but it will be CNE the entity that grants permits for such infrastructure management. In any case, due to their social and public interest, PEMEX and its affiliates will have priority access to the capacity of new transportation projects or to increase the capacity of existing infrastructure.
- ✓ PEMEX is exempted from open access obligations in the transportation, distribution, and storage of hydrocarbons and refined products infrastructure. The open access obligation relates to the monopolistic nature of a pipeline along the route it serves. In many cases, a pipeline is the only option for a user to receive the hydrocarbons, petroleum products, or petrochemicals needed for their industrial activities. The removal of this obligation for PEMEX would allow it to deny services to market users without justification, which is anticipated to disrupt the market and cause significant concern among users, who would be deprived of the ability to contract transportation services for hydrocarbons, refined petroleum products, or petrochemicals through other means in the absence of pipelines.

- ✓ PEMEX and its affiliates are exempt from rules and restrictions on cross-participation, meaning that PEMEX' economic interest group could participate unrestrictedly in the full hydrocarbon value chain, leveraging synergies and gaining advantages over competitors.
- ✓ The proposed bill would repeal all asymmetric regulations and rules governing first-hand sales applicable to PEMEX².
- ✓ A transitory regime is included where SENER is empowered to determine the quality specifications for petroleum products, including access obligations for sample collection and result submission to CNE.

C. Combating illicit activities ("huachicol" and "huachicol fiscal")

The LSH bill proposes a comprehensive regime for verifying compliance with the regulatory framework, including weekly reporting obligations for permitted activities and the possibility for SENER and CNE to exchange information and collaborate with all government authorities in their supervisory functions.

In exercising their powers, SENER or CNE, as applicable, may determine the provisional suspension of permitted activities in the following cases:

- ✓ If the legal origin of the product being imported, exported, transported, marketed, stored, distributed, or sold is not verified.
- ✓ If there are signs of harm to a final user from the product at any point in the value chain.
- ✓ If there are signs of alteration or adulteration of the product at any point in the value chain.
- ✓ If there are signs of practices that encourage illicit markets or hydrocarbon smuggling, or any other related crime.
- ✓ If there are signs that such activity endangers human life, health, public safety, the environment, facility security, or public property.

Information shared with authorities in the exercise of their verification and supervisory powers will not be subject to commercial, banking, fiscal, or fiduciary secrets.

² First-hand sale agreements would need to migrate to commercialization agreements within the next 180 days after the publication of the LSH.



Additionally, for permit application, proof of legitimate ownership or possession of the product related to the request must be provided. The request must be aligned with planning criteria while promoting the healthy development of the market, as determined by SENER or CNE.

D. New social impact assessment in the energy sector

Any entity seeking a permit or authorization related to hydrocarbons (including the parties to an entitlement or a CEE) must present a social impact statement to SENER for approval. The statement replaces the social impact evaluation, providing additional details and characteristics. The development of infrastructure tied to the project requires the definitive approval of the social impact statement.

It is important to mention that an exemption regime regarding these social impact assessments is included. The social impact statement will not be required for: (i) permits for importing and exporting hydrocarbons and petroleum products; (ii) authorizations requested by assignees or contractors to perform activities in the relevant area as part of their approved plans; and (iii) commercialization permits for hydrocarbons, refined petroleum products, and petrochemicals.

E. Sanctions

In the sanctions chapter, several additional non-compliance scenarios are included that could result in fines. Notably, the following cases could be sanctioned by SENER or the CNE:

- ✓ SENER may impose fines and sanctions for:
 - Failure to meet requirements regarding electronic information platform integration.
 - Failure to meet requirements for negotiations and surface use agreements.
 - Engaging in hydrocarbon development and production without an approved measurement system by the CNE.
 - Conducting permitted activities related to products without proving their lawful acquisition during verification.
 - Modifying technical conditions of systems, pipelines, installations, or equipment without prior authorization.

- Non-compliance with quantity, quality, and product measurement provisions.
 - Generating damage from products involved in permitted activities.
 - Adulterating or altering products, including joint liability in fiscal matters.
 - Non-compliance with social impact assessments or beginning development without approval.
- ✓ CNE may impose fines and sanctions for:
- Conducting permitted activities related to products without proving lawful title, as evidenced during verification by the authority.
 - Engaging in activities affecting the product’s end user.
 - Non-compliance with quantity, quality, and product measurement provisions.
 - Adulterating or altering products, including joint liability with respect to related fiscal matters.

It is relevant to note that the amount of the fines in many cases has been doubled compared to the current value in the LH. Additionally, an indirect damages analysis will be done when determining fines, which could lead to excessive sanctions.

F. Authority of SENER and CNE

While there is a division of powers between SENER and CNE for the purposes of the LSH, this distribution is not entirely clear. In principle, the separation of powers with respect to permitted activities, is as follows:

Sector	Activity	Issuing/responsible authority
Upstream	Reconnaissance and surface exploration activities	SENER
	Approval of plans and programs ³	SENER
	Drilling of wells	SENER
	Oil treatment	SENER
Midstream and Downstream	Import and export of gas, petroleum products and petrochemicals	SENER

³ The approval of exploration and development plans will not be longer considered as deemed approvals in case the authority does not resolve in time.

	Import, export, transport ⁴ , storage and commercialization of crude oil	SENER
	Creation of integrated systems ⁵	SENER
	Management of integrated systems	CNE
	Processing, liquefaction, regasification, compression, decompression, transportation, storage, distribution, and marketing of natural gas	CNE
	Formulation, transportation, storage, distribution, and marketing of refined petroleum products	CNE
	Transportation, storage, and marketing of petrochemicals	CNE
	Oil refining	SENER
	Public sale of natural gas	CNE
	Public sale of petroleum products	CNE
General	Social impact assessment for the energy sector	SENER

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⁴ Within the collection term, this activity is expressly not considered as part of the regulated activity of transportation.

⁵ The SENER must provide priority to the capacity designation in favor of PEMEX and its affiliates for all new transport projects, or in the capacity increase of existing infrastructure, as it is considered public interest.

