Mexico's New Petroleum Law: The Internal Reforms at Pemex and the North American Free Trade Agreement

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Mexico's New Petroleum Law: The Internal Reforms at Pemex and the North American Free Trade Agreement**

Mexico has adopted new federal legislation for the restructuring and modernization of its oil, gas, and petrochemical industry. Additionally, Mexico has negotiated a free trade agreement with the United States and Canada. With both these initiatives Mexico will consolidate a new petroleum law.

This article first discusses Mexico's constitutional basis regarding the ownership of domestic hydrocarbons. Next follows an analysis of Petróleos Mexicanos' (Pemex) juridical framework, Mexico's petroleum law, and other relevant federal statutes, highlighting issues related to service contracts and risk contracts. Further, this article comments briefly on the modernization program in the Mexican oil, gas, and petrochemical sector and the recent reforms adopted by Congress that have restructured Pemex and created four new entities. Finally, the article addresses the impact of the North American Free Trade Agreement (NAFTA).

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**This article was current as of the date of submission on September 30, 1993. As part of the implementation process of the NAFTA, several federal statutes quoted herein will be amended, derogated, or abrogated as of January 1, 1994. The Editorial Reviewer for the article was James H. DeMent, Jr.
I. Constitutional Basis

Under the Mexican Constitution the ownership of petroleum and all solid, liquid, and gaseous hydrocarbons is vested in the state. The ownership of such natural resources is a constitutional right that is imprescriptible and not subject to alienation. Accordingly, any type of concession or contract for the exploitation of Mexico's domestic hydrocarbons is strictly proscribed.

In 1958, Mexico's federal Congress enacted a law aimed at regulating and implementing this constitutional mandate in the petroleum sector. Congress construed article 27 of the Constitution by broadly defining what the "petroleum industry" legally means. The petroleum industry encompasses, inter alia, the exploration, exploitation, refining, transportation, storage, distribution, and first-hand sale of petroleum, natural gas, byproducts obtained from them, and basic petrochemicals. Thus, all the phases of the oil and gas business in Mexico have been exclusively reserved to the Mexican Government. The legal entity entrusted by the federal Congress to conduct and control economic activity in this industry is Pemex, along with the recently created organismos subsidiarios (subsidiaries). By operation of law and for the benefit of the Mexican nation,
Pemex is in charge of a vertically integrated monopoly in the oil and natural gas industry.

All domestic hydrocarbon resources (whether solid, liquid, or in gas form) and basic petrochemicals are deemed to be "strategic activities." Under Mexican law strategic activities are those economic activities of paramount importance to the nation and constitutionally reserved to the state. The Mexican state develops these strategic activities through decentralized public entities. Private participation, either national or foreign, is clearly prohibited. However, Mexican law permits indirect participation, or portfolio investment. Congress regulates these strategic activities by imposing a vertical state monopoly on Mexico's petroleum industry and exclusively reserving to the state the right to the strategic activities.

II. Pemex's Legal Status

Mexico's petroleum and natural gas law may be established by analyzing existing Mexican law and the legal framework of Pemex and its subsidiaries. Pemex was chartered by an act of the Mexican federal Congress in 1938, follow-
ing the nationalization and expropriation of Mexico's oil industry some months before.  

Under Mexican law the President is in charge of the federal public administration which, in turn, is divided into two distinguishable sectors: centralized and parastatal. Pemex and its subsidiaries are considered parastatals, since the law regards them as decentralized public entities.

A. Applicable Regulations

The activities of Pemex and its subsidiaries are subject to many regulations and statutes. First, Mexico's federal jurisdiction exclusively controls the oil industry. However, private law governs many acts of Pemex and its subsidiaries. Nonetheless, Pemex and its subsidiaries' petroleum and gas operations are concurrently or exclusively regulated by public policy provisions.

Although Pemex and its subsidiaries have a separate legal existence and technically are independent from the federal government, they still remain tied to the

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18. For Mexico, what had occurred was a great symbolic and passionate act of resistance to foreign control, which would be central to the spirit of nationalism that tied the country together. To the companies, the expropriation was absolutely illegitimate, a violation of clear agreements and formal commitments, a denial of what they had created by risking their capital and energies. The 1938 nationalization was seen as one of the greatest triumphs of the revolution. Mexico was the complete master of its oil industry, and Petróleos Mexicanos—Pemex—would emerge as one of the first and most important state-owned oil companies in the world. Mexico had, indeed, established a model for the future. Daniel Yergin, *The Prize: The Epic Quest For Oil, Money, and Power* 276, 279 (1991); see also Decreto Expropiatorio [Expropriation Decree], D.O. (Mar. 19, 1938).


20. Pemex and its subsidiaries have been endowed with their own legal personality and patrimony. Each validly exists as an independent legal entity and is fully qualified and empowered to own assets and carry on business activities in each jurisdiction of Mexico. All decentralized entities such as Pemex, public enterprises, trust funds, and other forms of legal entities in which the federal government or other public instrumentality owns a majority interest, or has a reserved right to exclusively subscribe a specific class of stock, or where the federal government has the power to control the administration of the juridical entity, fall within the category of parastatal entities. See Ley Orgánica de la Administración Pública Federal [Organic Law of the Federal Public Administration], D.O. (Dec. 29, 1976) arts. 45 et seq. [hereinafter Organic Law]. See also Parastatal Law, supra note 10, art. 2.


22. The Mexican Constitution has reserved to the federal Congress the power to legislate throughout the Mexican territory on hydrocarbons. See *Mex. Const.* art. 73, pt. X; see also Petroleum Law, *supra* note 2, art. 9.

23. The activities performed by Pemex and its subsidiaries within the oil industry are considered commercial activities. See Petroleum Law, *supra* note 2, art. 12; Código de Comercio [Commerce Code] art. 75, § IV. Pemex and its subsidiaries are deemed to be decentralized public agencies of the federal government of the United Mexican States, of technical, industrial, and commercial nature. See Pemex Charter, *supra* note 6, art. 3.

24. Orden público provisions are those statutory regulations where party autonomy is very limited, foreign law cannot apply, and above all, obligatory compliance is required. Almost all of the statutes quoted herein contain public policy dispositions.

25. See, e.g., Parastatal Law, *supra* note 10, art. 11.
central government. For instance, Pemex and its subsidiaries’ budget and planning are governed by federal regulators. 26 Each fiscal year the budget of Pemex and its subsidiaries must be prepared by the federal government, approved by Congress, and published in the official gazette in order to be legally binding. 27 Congress annually authorizes the Federal Revenue Law, which provides the debt ceilings that parastatals must observe for the coming fiscal year. The financial programs of Pemex and its subsidiaries are supervised by the Ministry of Finance and Public Credit, and any credit requests must be approved and registered before that Ministry. 28 Therefore, Pemex’s capital expenditure and investment programs depend on the central government, specifically the Ministry of Finance and Public Credit. That ministry also consolidates and elaborates Pemex’s budget and puts it before Congress to be voted on. 29 A technical body of the chamber of deputies called Contaduría Mayor de Hacienda annually reviews and approves the consolidated financial statements and balance sheets of Pemex and its subsidiaries. 30 Under the new Pemex Charter, Pemex is responsible for the annual accounting and financial consolidation of all entities owned or controlled by Pemex, including its subsidiaries. 31 Thus, the achievement of their sectoral plans and institutional programs and the compliance of their budgets is subject to the general review, assessment, and approval of Congress. 32 The disposal of funds and Pemex’s capital expenditures are also subject to surveillance by the Comptroller’s Office.

26. Mexico has a National Development Plan that has to be promulgated within the first six months after the new President has assumed control of the executive branch. This plan not only enumerates the economic policies to be taken care of by the ongoing administration, but also indicates the sectoral and regional programs in which the parastatals—like Pemex and its subsidiaries—have a pronounced participation, along with the corresponding institutional programs directly assigned to those parastatal entities. Currently, Pemex and the subsidiaries are globally managed by the National Energy Modernization Plan. See Ley de Planeación [Planning Law], D.O. (Jan. 5, 1983). Regarding Pemex and the subsidiaries’ compliance to such sectoral and institutional programs, see Parastatal Law, supra note 10, arts. 46 et seq.

27. The Regulatory Law [Pemex’s Decree] passed pursuant to the Mexican Constitution specifically creates a national oil company, Pemex, to implement the National Development Plan for hydrocarbon resources. Pemex is not privately owned and is governed by a council (Consejo de Administración) composed of Presidential appointees. Decisions made by the governing council are made in furtherance of Mexican National policy concerning its Petroleum resources.


31. Pemex Charter, supra note 6, art. 5.

32. See generally TRINIDAD LANZ, LA CONTRALORIA Y EL CONTROL INTERNO EN MÉXICO 527 (1987).
of the federal government.\textsuperscript{33} Similarly, specific fiduciary duties with strict standards of care and loyalty govern the incumbent officials of Pemex, its subsidiaries, and many of their employees.\textsuperscript{34}

As one might imagine, Pemex and its subsidiaries are also subject to a special fiscal regime; they do not pay dividends or income taxes, but they do pay a substantial sum of their total revenues to the treasury by means of exploitation "duties."\textsuperscript{35} Traditionally, the government based the tax regime placed upon Pemex upon the gross revenues received from the sale of crude oil, natural gas, and byproducts. However, because of the need to fortify autonomy and encourage modernization of its operations, income tax regulation and other statutory schemes were realized.\textsuperscript{36} As of 1993 the government modified Pemex's special tax regime in order to establish a more stable fiscal scheme. In addition to paying contributions prescribed under Mexican tax law, except regular income taxes, the law requires Pemex to pay oil extraction duties, both ordinary and extraordinary, tax on oil income, and duties on hydrocarbons.\textsuperscript{37}

Labor relations of Pemex and its subsidiaries are also subject to the exclusive jurisdiction of Mexico's federal authorities.\textsuperscript{38} Every two years Pemex negotiates and signs a collective bargaining agreement with the Petroleum Workers Union of the Mexican Republic. This collective bargaining agreement encompasses the entire petroleum, gas, and basic petrochemical industry, which Pemex controls.\textsuperscript{39}

Moreover, a federal statute specifically protects and regulates a significant bulk

\textsuperscript{33} Article 134 of the Mexican Constitution reads:  
The economic resources available to the Federal Government and the Government of the Federal District, as well as their respective Parastatal Administrations, shall be administered with efficiency, efficacy and honesty to satisfy the objectives that they are bound for . . . (p)ublic officials shall be responsible for the compliance of these dispositions as provided in chapter IV of this Constitution.

\textsuperscript{34} See Ley Federal de Responsabilidades de los Servidores Públicos [Federal Public Servants Responsibilities Law], D.O. (Dec. 31, 1982).

\textsuperscript{35} Mexico's federal Congress is empowered to levy taxes "[o]n the utilization and exploitation of the natural resources embodied in paragraphs 4th and 5th of Article 27." MEX. CONST. art. 73, pt. XXIX(2); see Ley del Impuesto Especial sobre Producción y Servicios [Special Tax Law on Production and Services], D.O. (Dec. 30, 1980).


\textsuperscript{37} See Ley de Ingresos de la Federación para el Ejercicio Fiscal de 1993 [Federal Revenue Law for the Fiscal Year of 1993], D.O. (Jan. 1, 1993) art. 4; \textit{see also Régimen Fiscal de Pemex y sus Organismos Subsidiarios, 1993, Petrofinanzas}, Oct.-Dec. 1992, at 11. The author foresees that for 1994 the tax regime for Pemex and its subsidiaries will be reformed. The current taxes and duties will be allocated among the subsidiaries in accordance with the line of business assigned to them. Tantamount to an income tax, each subsidiary will pay a tax on gross revenues and also withhold and deliver the value added tax. \textit{See Nuevo Régimen Fiscal para Pemex a Partir de 1994; Informard Sobre Impuestos Generados, El Financiero}, July 14, 1993, at 8.

\textsuperscript{38} See MEX. CONST. art. 123, § A, pts. XXXI(a)8 & 9, (b)1; \textit{see also Ley Federal del Trabajo [Federal Labor Law].}

\textsuperscript{39} The director general of Pemex has been exclusively empowered for the negotiation of the collective bargaining agreement with the union, and is also entitled to issue the Reglamento de Trabajo del Personal de Confianza [Work Regulations Governing the Confidential Personnel]. \textit{See Pemex Charter, supra note 6, art. 13, § III.}
of the properties and assets of Pemex and its subsidiaries.\footnote{See Ley General de Bienes Nacionales [General Law on National Patrimony], D.O. (Jan. 8, 1982).} The patrimony owned by Pemex and its subsidiaries is imprescriptible, subject to many legal constraints, including immunity from attachment, attachment in aid of execution, or execution from an adjudicatory contest,\footnote{See, e.g., id. arts. 2, 3, 4, 16, 35, 60; see also Código Federal de Procedimientos Civiles [Federal Code of Civil Procedure]. See also the immunity granted under the U.S. Foreign Sovereign Immunities Act to certain property owned by an agency or instrumentality of a foreign state. 28 U.S.C. § 1609 (1976). But see the exceptions established in id. § 1610.} and special choice of law and forum regulations.\footnote{See General Law on National Patrimony, supra note 40, art. 7.} Likewise, dispute resolution with Pemex\footnote{"Federal law shall be applied to all acts, agreements and contracts in which Petróleos Mexicanos is involved, and disputes in which it is a party, of whatever nature, will belong to the exclusive jurisdiction of the federal courts." Pemex Charter, supra note 6, art. 14. In the author's view, this provision does not purport to have an extraterritorial reach. Thus, Pemex's specially tailored choice of law and forum rules should only apply domestically. Furthermore, the author does not construe the term "exclusive jurisdiction" as the principle of law commonly used and referred to in private international law. For further analysis on the matter, see Fernando A. Vázquez Pando, Mexican Law of Judicial Competence, 12 Hawai' i Int'l L.J. 337, 356-57 (1990); Fernando A. Vázquez Pando, The Mexican Debt Crisis in Perspective: Faulty Legal Structures and Aftershocks, 23 Tex. Int'l L.J. 171 (1988); Fernando A. Vázquez Pando, Consideraciones Jurídicas sobre la Teoría y la Práctica de la Inversión Extranjera Indirecta en México, a través de Financiamientos, Address Before the First Seminar on Private International Law at Universidad Nacional Autonoma de Mexico (UNAM) (Oct. 1977), in PRIMER SEMINARIO NACIONAL DE DERECHO INTERNACIONAL PRIVADO 25, 45-49 (UNAM 1979). On the other hand, article 14 of the Pemex Charter was recently unsuccessfully challenged before the U.S. Fifth Circuit Court of Appeals. The issue before the court was whether article 14 should be interpreted as an implied waiver of the United States Foreign Sovereign Immunities Act, 28 U.S.C. § 1605(a)(1) (1976).} has become increasingly complex domestically and overseas\footnote{"If adopted, Arriba's imaginative 'sue and be sued' theory of implied waiver would presumably deny Pemex sovereign immunity in most if not all future actions to which it is a party. We decline to adopt the theory. . . . Consequently, Pemex's enabling legislation, without more, is hardly a waiver of its sovereign immunity within the meaning of the FSIA.\" Arriba, Ltd. v. Petróleos Mexicanos, 962 F.2d 528, 538-39 (5th Cir. 1992) (footnotes omitted).} by virtue of the fact that Pemex interacts as an instrument of the state's sovereignty and also as a commercial player.
In spite of the fact that Pemex and its subsidiaries are amenable to exclusively conduct and develop the petroleum industry,\textsuperscript{45} Pemex and its subsidiaries remain capable and empowered to enter into a vast variety of contracts and transactions\textsuperscript{46} including service and public works contracts, which are generally governed by the Mexican Constitution and implemented by federal statutes.\textsuperscript{47} These statutes were envisioned for the procurement of goods by the government and its parastatals (such as Pemex and its subsidiaries) and the rendering of services and works for the benefit of these parastatals.\textsuperscript{48}

B. SERVICE CONTRACTS

In order to comply with the above-mentioned constitutional mandate, federal legislation has imposed legal constraints that directly and indirectly regulate service and public works contracts. Those restraints require that:

(i) The petroleum industry must be exclusively conducted and controlled by Pemex with the assistance and support of its subsidiaries;\textsuperscript{49}

(ii) The first-hand sale of domestic hydrocarbons and retailing of petroleum

resolution in the international arena in order to avoid the extraterritorial arm of U.S. jurisdiction. These mechanisms include settling complaints by means of arbitration, mediation, and litigation in Mexican forums or another convenient jurisdiction.

45. Pemex, along with its subsidiaries, remains the only juridical persons legally empowered, with authority granted by Congress, to exclusively conduct and control the oil industry on behalf of the state. Nevertheless, Congress may lawfully authorize other public instrumentalities or agencies to participate in such a strategic activity. See Petroleum Law, supra note 2, art. 4; Parastatal Law, supra note 10, art. 14, § I; Pemex Charter, supra note 6, art. 3.

46. See Pemex Charter, supra note 6, art. 4; Petroleum Law, supra note 2, art. 6.

47. See MEX CONST. art. 134; Ley de Obras Públicas [Public Works Law], D.O. (Dec. 30, 1980), amended by D.O. (July 18, 1991); Reglamento de la Ley de Obras Públicas [Regulations to the Public Works Law], D.O. (Feb. 13, 1985), amended by D.O. (July 18, 1991); Ley de Adquisiciones, Arrendamientos y Prestación de Servicios Relacionados con Bienes Muebles [Law for Acquisitions, Leases and Rendering of Services Related to Movable Goods], D.O. (Feb. 8, 1985), amended by D.O. (July 18, 1991) [hereinafter Procurement Code]; Reglamento de la Ley de Adquisiciones, Arrendamientos y Prestación de Servicios Relacionados con Bienes Muebles [Regulations to the Law for Acquisitions, Leases and Rendering of Services Related to Movable Goods], D.O. (Feb. 13, 1990), amended by D.O. (July 18, 1991); Reglas Generales para la Contratación y Ejecución de Obras Publicas y de Servicios Relacionados con las Mismas para las Dependencias y Entidades de la Administración Pública Federal [General Rules for the Execution and Performance of Public Works and Service Contracts Thereof Applicable to the Agencies and Entities of the Federal Public Administration], D.O. (Oct. 15, 1982). On May 27, 1993, the board of directors of Pemex made the following resolutions: (i) the express authorization from the board of directors to the directors general of Pemex and subsidiaries for the execution of service contracts, (ii) the execution of such service contracts will only be allowed with respect to those cases where such services cannot be provided through Pemex and its subsidiaries' own personnel and resources, and (iii) the officials shall refrain from surpassing the relevant budget item.

48. See Public Works Law, supra note 47, art. 2; Procurement Code, supra note 47, art. 2. Regarding public works contracts, in general, see JORGE CANALS, EL CONTRATO DE OBRA PUBLICA (1991); see also JOAQUIN MÁRTINEZ, LOS CONTRATOS DERIVADOS DEL ARTICULO 134 CONSTITUCIONAL (1993).

49. Petroleum Law, supra note 2, art. 4; Pemex Charter, supra note 6, arts. 1-3.
products must be solely by the corresponding subsidiary, depending on the line of business it controls;\(^\text{50}\)

(iii) Pemex and its subsidiaries cannot assign, surrender, or transfer, or by any means sell, compromise, or engage the so-called "assignments,"\(^\text{51}\) nor the rights and duties that stem from them, nor shall the assignments be subject to attachment, levy, seizure, garnishment, or encumbrance of any sort or nature;\(^\text{52}\)

(iv) the oil and natural gas cannot be sold, attached, garnished, seized, encumbered, or by any means compromised, engaged, or transferred, while it remains unexploited and has not been extracted from the oil field;\(^\text{53}\)

(v) payments or compensation shall be made exclusively in cash for any of the services rendered or works carried out by Pemex or its subsidiaries; to stipulate, as remuneration, a percentage of the production or any participation in the results of such exploitations is therefore unlawful;\(^\text{54}\)

(vi) Pemex and its subsidiaries are not allowed to concede, surrender, or grant any type of royalties, percentages, or participation in the production of domestic oil, natural gas, or any byproduct derived from them;\(^\text{55}\) and

(vii) any pipeline established or located throughout the Mexican territory must be owned by Pemex.\(^\text{56}\)

In light of the above public policy dispositions Pemex's sectoral head (the Ministry of Energy, Mines, and Parastatal Industry) cannot assign operating rights to any party other than Pemex, its subsidiaries, or any other decentralized public agency specifically determined by a congressional decree.\(^\text{57}\) Such operating rights are nontransferable and cannot be compromised by any means. There are no concessions or license agreements. In any service or work contract all the crude oil and natural gas drilled and produced must belong to Pemex.

\(^{50}\) Petroleum Law, supra note 2, art. 3, § I; Enabling Petroleum Law, supra note 6, art. 3, § I; Pemex Charter, supra note 6, art. 2.

\(^{51}\) "Assignments" are sovereign acts whereby the state, through the sectoral head of Pemex (the Ministry of Energy, Mines, and Parastatal Industry), grants Pemex or any other decentralized public entity appointed by Congress (such as the subsidiaries), the authorization for the drilling and production of a determined oil field or well. The assignments are not within the stream of commerce so they are not subject to alienation, attachment, or any form of encumbrance. Assignments are instruments employed by the state to insure control over domestic hydrocarbons for the benefit of the nation. See Petroleum Law, supra note 2, art. 5; Enabling Petroleum Law, supra note 6, art. 5.

\(^{52}\) Enabling Petroleum Law, supra note 2, art. 5.

\(^{53}\) Id. art. 19.

\(^{54}\) Petroleum Law, supra note 2, art. 6.

\(^{55}\) Id.

\(^{56}\) See Enabling Petroleum Law, supra note 6, art 31. Although this disposition might not be directly relevant to the issue of service contracts, the reader should bear in mind its interrelated implications for the transmission or transportation of fuels in Mexico. In connection with this matter is the fact that Pemex has the exclusive right to import oil and gas into Mexico from abroad, namely, from the United States. See North American Free Trade Agreement [hereinafter NAFTA], annex 602.3(3). All references to NAFTA are to the December 17, 1992, draft.

\(^{57}\) See Petroleum Law, supra note 2, art. 4; Pemex Charter, supra note 6, arts. 1-3.
Additionally, risk-service contracts, production-sharing agreements, petroleum investment agreements, turn-key and standard drilling contracts, ad hoc joint ventures, or any type of service or public work contracts are unavoidably proscribed and unenforceable in the event that an interest, percentage, or a share of the production is conveyed to the independent contractor as a means of payment or compensation. Likewise, Mexican law strictly forbids earn-in agreements whereby the contributing party acquires an interest in a well upon the successful completion of the drilling contract, or a royalty, or a net profit interest in production. The law also prohibits the granting of any form of leasehold interest or oil and gas lease agreement. In sum, Pemex and its subsidiaries exclusively control the drilling and production of a well, despite the fact that they are legally capable of entering into service and work contracts.

Thus, if an independent contractor drills a well, or if an independent supplier furnishes a service contract, the law precludes such contractor from receiving as compensation a dación en pago (payment with kind or royalty in kind), with a participation or percentage of the hydrocarbon production. Finally, Pemex and its subsidiaries cannot transfer, assign, sell, surrender, use as a collateral, or compromise by any means an unexploited product that lies in the subsoil.

Nonetheless, if Pemex or any of its subsidiaries comply with their legal obligation of being the firsthand seller, the purchaser may freely transfer title of the oil and gas. Once title passes from Pemex or any of its subsidiaries to the purchaser, full and unrestricted power of alienation vests in the purchaser, except, of course, if the deal involves a title-retention type of sale, or probably even a

58. A risk-service contract is a contract "which places the burden of making original investments and taking risks on the company or 'contractor.' For successful efforts, the contractor is entitled to recover capital expended and interest plus a payment called the 'risk fee.'" HOWARD R. WILLIAMS & CHARLES J. MEYERS, MANUAL OF OIL AND GAS TERMS 1079 (8th ed. 1991). A "risk fee" does not necessarily have to be made in kind as participation in the production or a drilling of a well.

59. Curiously, many argue that the risk contract prohibition comes from the direct interpretation of the Expropriation Act of 1938. But the risk contract limitation comes from the 1958 Petroleum Law. The Petroleum Laws of 1940 and 1941 expressly allowed this type of contract, as provided in their articles 7 and 8 respectively. See Cuadro Comparativo entre las Leyes Reglamentarias del Articulo 27 Constitucional en Materia de Petróleo Publicadas en el Diario Oficial de: 9 de Noviembre de 1940, 18 de Junio de 1941 y 29 de Noviembre de 1958, PEMEX-LEx L.J., July-Aug. 1992, at 43-45.

60. This is, of course, once an assignment has been issued in favor of Pemex or to one of its subsidiaries, as provided by article 5 of the Petroleum Law and article 5 of the Enabling Petroleum Law. See LANZ, supra note 32.

61. See Pemex Charter, supra note 6, art. 4.

62. What's more, for all of Pemex's reaching out to foreigners for help, the Constitution and Mexican law prevent it from offering the one reward that would draw heavy investment and technology from American oil companies. The companies would come, they have made clear, if the payoff for their risk is a share of the oil they find and produce. See Louis Uchitelle, Pemex: Mexico's Hesitant Oil Giant, N.Y. TIMES, Mar. 4, 1993, at DI.

63. Even if title has been passed by Pemex and all of the incidents of ownership are vested in the buyer, the latter cannot engage in refining the product domestically. See Enabling Petroleum Law, supra note 6, arts. 23, 24.
conditional sale or a purchase money security interest, as provided under Mexican law.\textsuperscript{64}

As the reader can tell, the Mexican Government overregulates Pemex. Negotiating a contract with Pemex is always a difficult experience because of the bulk of regulations that govern and constrain the conduct of the parastatal. A cautious deregulation process seems to be necessary to allow Pemex to pursue its modernization.

C. Performance Contracts

One of the provisions of the NAFTA that prompted reaction from certain sectors of Mexico was the inclusion of performance contracts.\textsuperscript{65} This stipulation provides that signatories to the NAFTA must allow their state-run companies to enter into performance provisions within their service contracts.\textsuperscript{66}

Indubitably, through this disposition the NAFTA drafters sent a direct message to Mexico, purposefully drafting it in broad terms. First of all a performance contract is not a term of art under Mexican law, nor in the United States or in Canada. Thus, such a vague term is subject to varying interpretations depending on the governing law applicable to service contracts. One thing is certain at least under Mexican law: paying a percentage of the hydrocarbon production or a share of such output as compensation for a service contract performed by an independent contractor is unlawful.\textsuperscript{67} That does not mean that Mexican law bars Pemex or its subsidiaries from granting incentives to their contractors when those contractors successfully perform their obligations. The only thing clearly forbidden is that Pemex and its subsidiaries make a payment in kind by taking a percentage of the hydrocarbon production, or by granting as an incentive for the work performed a participation in drilling even if the end payment is made in cash.\textsuperscript{68}

\textsuperscript{64} See, e.g., compraventa con reserva de dominio or pacto con cláusula rescisoria. Código Civil para el Distrito Federal en Materia Común y para toda la República en Materia Federal [Federal Civil Code] [C.C.D.F.] arts. 2312, 2310.

\textsuperscript{65} See NAFTA, supra note 56, art. 602, annex 602.3(4).

\textsuperscript{66} "The use of performance clauses would bring Mexican contracting practices into closer conformity with world standards and should make contracting with Pemex more attractive for foreign companies." Thad Grundy, Former Deputy Assistant Secretary for International Affairs, U.S. Dep't of Energy, A Policy Overview of the North American Free Trade Agreement, Conference Before the Planning Forum, Houston Chapter 12 (Feb. 17, 1993).

\textsuperscript{67} Petroleum Law, supra note 2, art. 6.

\textsuperscript{68} Even if this performance contract provision had been clearer as to allowing Pemex and its subsidiaries to accord this type of "quasi-risk contract," this disposition would not have any legal effect in Mexico. Under Mexican constitutional law a treaty cannot derogate Mexican federal law. Thus, this NAFTA disposition cannot supersede or derogate the risk contract prohibition prescribed under article 6 of the Petroleum Law. See the Mexican principle of the autoridad formal de la ley in MEX. CONST. art. 72(f) which reads: "[i]n the interpretation, amendment, or repeal of laws or decrees, the same procedure shall be followed as that established for their enactment." See also MEX. CONST. art. 133. But see Fernando A. Vázquez Pando, Jerarquía Constitucional del Tratado de Libre Comercio en el Sistema Constitucional Mexicano, Remarks Delivered at the Conference Panorama Jurídico del Tratado de Libre Comercio, Sponsored by the Universidad Iberoamericana Law School, pt. I, at 35.
words, Mexican law prohibits any provision that the contractor will be paid by a monetary equivalent of a specified share or a percentage of production. 69

In light of the foregoing, and being cognizant of what the Constitution and the Petroleum Law mandate, the reasons that motivated the adoption of such a provision remain unclear to the author. Mexico has no proscription on stipulating performance incentives, so long as the independent contractors are excluded from receiving ownership rights or participating in profits from any output. 70

III. President Salinas's Modernization Program

Liquidity and financial troubles in Mexico during the 1980s led observers to call it the lost decade. During the 1980s hard currency was channeled to pay down Mexico's external debt obligation. 71 Pemex, as everyone concurs, played a crucial role as a catalyst of foreign exchange, but at a price. As a result of paying down debt, Mexico experienced a sharp decline in exploration and drilling production for many years. 72

Upon President Salinas's accession to office profound changes began in Mexico, including revitalizing Mexico's most valuable asset: the petroleum industry. 73 Instead of including Pemex within its extensive privatization program, Salinas decided to modernize the entity and, accordingly, the oil industry. 74 An aggressive National Energy Modernization Program was issued in 1990 calling for the enhancement of Pemex's production levels in order to meet domestic demand and to keep exports at 1.4 million barrels per day.

After the debt relief was accomplished, the Mexican government and Pemex finally resumed previously interrupted investment programs. Pemex launched a comprehensive restructuring survey in order to streamline operations. Pemex embarked on a complete reorganization program, which is currently in effect, to

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69. See supra text accompanying notes 58-64.
70. The purpose of this work is to make an analysis of the Mexican petroleum law from a legal perspective. An economic and political analysis of the subject, or whether the risk-contract limitation should be lifted, is deliberately omitted.
71. "The Mexican debt drama brought home, however, the reality that the global oil boom was over, and the fact that 'oil power' was less powerful than assumed. Oil could mean not only wealth but also weakness for a nation." YERGIN, supra note 18, at 732.
74. Since the breakup of Standard Oil Trust in 1911, the real wealth and power in the [world] industry has tended to come not from the downstream, refining and marketing, but from upstream, ownership and control of the oil in the ground. And that means the state-owned companies of the oil exporters have the preeminent position today. They are a diverse group—Saudi Aramco, Petróleos de Venezuela, Pemex in Mexico, the Kuwait Petroleum Company (at least until 1990), Statoil in Norway, to name a few.

YERGIN, supra note 18, at 777.
modernize operations. With Salinas’s modernization program Pemex’s dual role as a political instrument and a commercial player began to evolve towards a more integrated oil corporation. Pemex finally began to behave more like an international company rather than a political institution. As a consequence, Salinas’s and Pemex’s reforms have had a perceptible effect in international business transactions in the energy sector.

Since Pemex resumed exploration and increased drilling operations, many international contracts have been opened up for bids. A considerable number of procurement projects are currently being implemented, and meaningful turnkey service contracts have been awarded to U.S. investors. Pemex also awards many public works contracts based upon international public biddings. Thus, Pemex’s

75. "There has been a distinct move, spearheaded by the major Latin American countries (Chile, Argentina, Bolivia, Mexico, Brazil), towards restructuring state resource companies to make them less politicized, more commercially focused and accountable and more like private companies, in terms of business focus, autonomy and competitiveness." Thomas Walde, Recent Developments in Negotiating International Petroleum Contracts, PETROLEUM ECONOMIST 3 (Int’l Energy L. Special Supp., July 1992).


77. Pemex not only acted more aggressively in the international arena, but also started to enter into strategic alliances with other major international oil companies, actions never envisioned in the past by many politicians. See, for example, the joint venture between Pemex and Shell Oil Company for the purchase of 50 percent of the Deer Park refinery. But see, e.g., José Luis Manzo, El Convenio con Shell, ¿Vuelta al Pasado?, EXCELSIOR, Mar. 12, 1993, at 2-1. Even before, however, Pemex began to further internationalize the enterprise. On May 24, 1989, Pemex incorporated a Mexican stock company called P.M.I. Comercio Internacional, S.A. de C.V., a/k/a, PMI. Since Pemex has the controlling interest of this corporation—about 84 percent of shares, the rest of the stock distributed between Nafin and Bancomext, State development banks—PMI is also regarded as a parastatal. See discussion supra note 20. PMI is the head of another group of international ventures, such as Pemex Internacional España, S.A., PMI Holdings, N.V. (Antilles), PMI Holdings, B.V. (Holland), PMI Services, B.V. (Holland), PMI Services North America, Inc. (Houston), PMI Holdings North America, Inc. (Delaware), PMI Norteamérica, S.A. de C.V. (Mexico, D.F.), PMI Services Europe, Ltd. (London), PMI Trading, Ltd. (Ireland), and Repsol (Spain) (5%). PMI along with the above-cited group of international entities has been in charge of the international trade of Pemex’s products. See PETROLEOS MEXICANOS, MEMORIA DE LABORES 68, 69 (1992) (Pemex’s Annual Report).


80. See, for example, the cases of Triton International Corporation and Smith International, Inc. Id. Turnkey drilling contracts have helped Pemex to reduce delays and costs in upstream activities. See MARCOS-GIACOMAN, supra note 72, at 45.

81. The procurement of capital goods and technology transfer remain as key factors for the modernization of Pemex and its subsidiaries. Being aware that state of the art technology means the ability to stay in business in the oil industry, the federal Congress created, in 1965, the Instituto Mexicano del Petróleo (the Mexican Institute of Petroleum, or IMP). The IMP is also a decentralized public entity. Pemex, the IMP, and the private sector of Mexico have been able to develop and manufacture a significant technology for the oil industry. For that reason, Pemex, along with the IMP and certain Mexican corporations, incorporated a private stock company called Mexpetrol, S.A. de

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modernization endeavors are expected to enhance business opportunities for Canadian and U.S. oil-producing and oil service contracting companies. As Pemex and its subsidiaries' upstream activities increase, border sister states such as Texas will undoubtedly greatly benefit. As both Texas and Mexico share a border and have an oil-based economy, the flow of manufactured goods and services will be facilitated. Gas supplied to Mexico by Texas and other border states has been steadily increasing, along with other basic and secondary petrochemicals, even though Mexico produces large amounts of natural gas. Louisiana and California, sharing a border with Texas and with Mexico, respectively, and having such a strategic location, one on the Gulf of Mexico and the other on the Pacific Ocean, will also benefit as a consequence of Pemex's investment program.

Likewise, the international procurement of service and works contracts has been fueled by U.S. Eximbank loan guarantees and other financial deals. Because of Mexico's restriction on foreign direct investment, risk-service contracts, and the excessive and stringent tax regime placed on Pemex and its subsidiaries, Pemex must secure capital through external debt obligations. In order to cope with the modernization program Pemex has actively increased its sources of funding, specifically with the help of U.S. capital markets.

As of August 18, 1992, the list of basic petrochemicals was once again reclassified. Eight remained as basic petrochemicals and thirteen as secondary petrochemicals. The basic petrochemicals are: Ethane, Butane, Pentane, Hexane, Heptane, C.V., with the purpose of selling and advising customers abroad in regard to the transfer of technology in the petroleum industry. Pemex has 25 percent of the stock, the IMP 5 percent, and the rest of the shares are allocated among other Mexican equipment and oil field service companies. Furthermore, Pemex is also making strategic alliances in the environmental field, as with the company Servicios Integrales de Protección Ambiental, S.A., which was incorporated in conjunction with Grupo ICA, Chemical Waste Management, Inc., and the IMP. See PETROLEOS MEXICANOS, supra note 77, at 147.

82. See GAO/NSIAD-92-169 Mexican Oil, at 3; see also Hollis, supra note 79, at 26.


84. Id.

85. Even though Mexico's petrochemical sector is ranked first in Latin America with a huge potential and economic growth, Mexico has been suffering a trade deficit in this sector. See ERNESTO MARCOS-GIACOMAN, THE MEXICAN OIL INDUSTRY: FINANCING INVESTMENT IN A NEW ECONOMIC ENVIRONMENT 31 (1992).

86. "Mexico's position as a gas importer could reverse after the turn of the century." JUDITH DWARKIN, NORTH AMERICAN FREE TRADE AGREEMENT IN ENERGY 74 (1992). Lack of capital expenditure, poor pipeline and distribution infrastructure, environmental concerns, geographic constraints, market conditions, and other priorities were some of the reasons that have been attributed to the deficient development of the natural gas industry in Mexico, despite its enormous reserves. See Sharon Rejer, The Pemex Paradox, FIN. WORLD MAG., July-Aug. 1990, at 50; Hollis, supra note 79, at 27.

87. Fifty-six percent of Mexico's proven oil reserves are established in the Gulf of Mexico. In 1991, approximately 71 percent of the crude oil obtained was produced in offshore facilities located mainly in the Sound of Campeche. See PETROLEOS MEXICANOS, MEMORIA DE LABORES (1991).

Propane, Raw Material for Carbon Black, and Naphthas. The secondary petrochemicals are: Xylenes, Toluene, Propylene, Para-xiene, Ortho-oxylene, Methanol, N-paraffins, Benzene, Butadien, Acetylene, Ethylene, Ammonia, and Butyraldehyde. The law requires a permit from the Mexican Petrochemical Commission in order to produce secondary petrochemicals. Only up to 40 percent of outstanding shares may be acquired or controlled by foreign investors in a Mexican venture that produces secondary petrochemicals. Nevertheless, by using a trust fund for up to twenty years, such foreign investment limitations may be circumvented in accordance with the recently promulgated investment regulations. Under a law pending before Congress all restrictions on foreign investments in the manufacture of secondary petrochemicals will be removed. A reason for this pending law is that under article 1102 of the investment chapter of the NAFTA, Mexico has agreed to eliminate the current 40 percent limitation on foreign investment for all nonbasic petrochemicals. NAFTA takes precedence because under Mexican law a treaty cannot derogate federal law. Recently, one of the subsidiaries (Pemex-Petroquímica), along with the Ministry of Finance of Mexico, announced that it would accelerate privatization of those parts of the petrochemical sector not exclusively reserved to the state (secondary petrochemistry). Through an international bidding process Pemex, Pemex-Petroquímica, and the Ministry of Finance will sell sixty petrochemical plants.

A. THE RESTRUCTURE OF PEMEX AND THE OIL INDUSTRY

Lately, Salinas has called for the acceleration of Pemex's modernization program; and Congress recently passed a presidential bill to amend the Pemex Charter. With this reform initiative Pemex is being decentralized and restructured into four distinct parastatals. Thus, as Pemex is restructured and reorganized, the oil, gas, and basic petrochemical industry of Mexico also becomes restructured.

The four new decentralized public entities created by Congress are:

(1) Pemex-Exploración y Producción (controlling the exploration, drilling,
and production of oil and natural gas; its transport, storage in terminals, and its marketing);

(2) Pemex-Refinación (controlling refining; manufacturing of oil products and oil derivatives that may be used as basic industrial raw materials; storage, transport, distribution, and marketing of the products and derivatives);

(3) Pemex-Gas y Petroquímica Básica (controlling the industrial processing of natural gas, natural liquid gas, artificial gas, and basic petrochemistry; storage, transport, distribution, and marketing of these products, as well as the derivatives that may be used as basic industrial raw materials); and

(4) Pemex-Petroquímica (controlling the secondary petrochemistry and industrial petrochemical processes whose products are not part of the basic petrochemicals, as well as the storage, distribution, and marketing).  

The main purpose of the legislation was to restructure Pemex in order to modernize the oil industry. Congress based the bill upon two premises: to maintain the Mexican Government’s ownership and control over the domestic hydrocarbons, and to maintain Pemex’s central management over each one of the areas in which the industry’s activities are to be restructured, ranging from exploration to the marketing of products. In compliance with the Constitution and applicable federal statutes, the state will retain ownership and control over Pemex and the four newly created autonomous incorporations. The Petroleum Law will not be modified, and its regulations will not suffer any change. The most significant change is that the petroleum industry will no longer be entrusted to just one entity, Pemex, but to four more organismos subsidiarios legally and administratively independent, but ultimately controlled by Pemex.

B. THE RELATIONSHIP BETWEEN PEMEX AND ITS SUBSIDIARIES

Under the new law Pemex and its subsidiaries will jointly maintain the structure of an integrated oil company. Pemex and the subsidiaries will be responsible for the development of Mexico’s petroleum industry. Pemex will be in charge of the strategic management, central planning, and general control of the subsidiaries and, in that sense, of the petroleum industry. Nonetheless, the subsidiaries will

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96. See Pemex Charter, supra note 6, art. 3.
97. See Pemex Charter, supra note 6, Explanation of Motives, at 12.
98. See the constitutional analysis of Ortega San Vicente, supra note 2, at 50-54. Notwithstanding these considerable endeavors to modernize the oil industry, several reactionary voices remain. See, e.g., the controversial legal analysis of the reforms expounded by Emilio Krieger, El Petróleo Debe Rescatarse del Entreguismo Globalizador, Excélsior, Mar. 12, 1993, at 3-1.
99. See MEX. CONST. art. 25; Petroleum Law, supra note 2, art. 14; Parastatal Law, supra note 10, art. 14, § 1; see also Organic Law, supra note 20, art. 45.
100. Pemex Charter, supra note 6, Explanation of Motives, at 17.
101. “Central administration should be understood as being the establishment of the system that confers the industry’s general strategic management upon Petróleos Mexicanos and decentralizes technical operations in organizations within a framework of unified collaboration and coordination.” Id. at 18.
remain technically and legally independent juridical entities ready to implement the corporate purposes assigned to them.

The four *organismos subsidiarios* are decentralized public entities similar to Pemex. Under Mexican administrative law only decentralized public entities could develop a strategic activity such as the petroleum industry. Decentralized public entities are created by an act of Congress or by an executive decree. Wisely, Salinas decided to incorporate the subsidiaries through Congress instead of by an executive order.

The Petroleum Law of 1958 expressly establishes that Pemex is exclusively entrusted with the development of the petroleum industry along with other decentralized public entities that in the future may be created by law. Thus, these four new parastatals incorporated as decentralized public entities will have their own separate legal existence and patrimony, fully empowered to carry on the line of business assigned to them. However, these subsidiaries will still be under the umbrella of Pemex. It should be noted that the term "subsidiary" is an innovative term under Mexican administrative law and also has other different legal concepts attached to it.\(^{108}\)

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102. *See* Parastatal Law, *supra* note 10, art. 14, § I. A prima facie contradiction exists with the creation of Pemex-Petroquímica. The contradiction is based on the fact that Pemex-Petroquímica, as a decentralized public entity, will be in charge of an economic activity that is not strategic; neither will it provide a public service or social assistance as required under article 14 of the Parastatal Law. Likewise, many of its activities will be gradually left to private parties, and many of its petrochemical facilities will be privatized. Lately, the director general of Pemex, in a plausible effort to decentralize Mexico City's profound bureaucratic concentration, announced that Pemex-Petroquímica headquarters was being forthwith transferred to Coatzacoalcos, a city in the State of Veracruz. In the same act, Francisco Rojas, the chief executive officer of Pemex, also announced that within a period of one year, Pemex-Exploración y Producción headquarters was going to move to one of the major cities located southeast of Mexico City, possibly to Villahermosa, the capital of the State of Tabasco. *See* Francisco Rojas, *Speech at the 55th Anniversary of the Oil Expropriation* (Mar. 18, 1993), *reprinted in Informe* 32 (1992). Wisely, one of the saving provisions embodied within the Pemex Charter, article 4, established that the legal domicile of Pemex and its subsidiaries will be in Mexico City, the Federal District, unless the executive branch provides otherwise. *See also* Pemex, *Sólo de México: Salinas, El Financiero*, Mar. 19, 1993, at 1.

103. *See* Organic Law, *supra* note 20, art. 45.

104. President Salinas could have chosen to create the subsidiaries by an executive decree, in lieu of passing the legislation, and avoid the two houses of the federal Congress. Nevertheless, due to the importance that is always associated with the oil industry in Mexico, Salinas chose to proceed with the debate and approval of the law by Congress. Notwithstanding that the ruling party controls both houses, the passing and approval of the bill was supported by most of the opposition parties except the most important left-wing party, the Partido de la Revolución Democrática. *See* Pemex Charter, *supra* note 6, Legislative History.


106. *See id.* art. 3.


108. In terms of liability, the newly created entities could be construed to be subsidiaries of Pemex's obligations, that is, that the subsidiaries will substitute, supply, or fortify Pemex's obligations. *Diccionario de la Real Academia Española* 1266 (1984). "One who or that which furnishes supplemental aid or supplies; an auxiliary; assistant." *New Illustrated Webster's Dictionary*
The Pemex Charter establishes two types of joint and several obligations: one retroactive, the other prospective. The first works by operation of law, the second by agreement. The retroactive joint and several liability of the subsidiaries with respect to Pemex’s payment obligations is provided by operation of law within the Pemex Charter. In order to avoid a material breach of any credit obligation, or especially to avoid an international loan default, one of the saving provisions of the Pemex Charter established that the new law “will not affect in any way the national and international payment obligations of Petróleos Mexicanos contracted before this regulation came into effect. Therefore, the organismos subsidiarios that this law established will be jointly and severally liable for the payment of such obligations.”9 With this saving provision the Mexican Congress sent a direct message to the international financial community. That message was that Pemex was not trying to avoid its international financial obligations because it was subject to a restructure decree or because of the fragmentation of Pemex’s assets and operations. Essentially, Pemex was worried about three major covenants within its international loan agreements. First, a representation and warranty that Pemex shall always remain the only entity in Mexico entitled to exploit and develop the petroleum industry; second, a representation and warranty (or a negative pledge) that the assets and properties of Pemex shall not be substantially transferred to other entities; third, and closely linked with the other two, Pemex’s covenant to refrain from committing an event of default as stipulated in the contract. This concern was more significant because of cross-default provisions within some international credit agreements of Pemex and the Mexican federal government. One may say that upon promulgation of the Pemex Charter, a technical loan default occurred. But this loan default, if any, no longer continues.

960 (1992). That would mean that in the event that Pemex fails to comply with its obligations, the subsidiaries will substitute or supply Pemex. This approach is not only inappropriate, but misleading. Pemex and each subsidiary has its own separate legal identity, and, above all, the Pemex Charter establishes that these entities will have the nature of being subsidiaries with respect to Pemex, to the extent provided within the Pemex Charter. Pemex Charter, supra note 6, art. 3. Another confusing interpretation is the corporate ownership approach because it might consider the term “subsidiary” as a parent-subsidiary relationship, that is, that Pemex owns the subsidiaries. Pemex cannot be the owner or a holding of another decentralized public entity; only the state can be the “owner” of an organismo público descentralizado. Decentralized public entities do not have stock, equity, stated capital, or any title of ownership. See MEX. CONST. art. 25, para. 4; Petroleum Law, supra note 2, art. 4. It would be more accurate, however, if we utilize the concept of corporate control in order to determine the subsidiary relationship of Pemex vis-à-vis the subsidiaries. See the definition of “[u]nder another’s control” in BLACK’S LAW DICTIONARY 1281 (5th ed. 1979). Under the new law Pemex will carry out the central administration and overall control of the oil industry. The new law vests Pemex with the exclusive power of being the central guidance of the oil industry. With this power, Pemex has the undisputed control of the subsidiaries, despite the fact that they have their legal autonomy and they do not have an “owner.” Pemex has the central administration and overall control of the oil industry, which is to be implemented through the board of directors and the director general of Pemex. See Pemex Charter, supra note 6, Explanation of Motives, at 18. See also generally Parastatal Law, supra note 10, art. 17.

109. Pemex Charter, supra note 6, art. 8, Transitory Provision.
The same day that the Pemex Charter was published, the breach was juridically remedied due to the transitory provision of article 8. This saving provision is virtually a "guaranty" from Congress to Pemex's lenders that the subsidiaries created by the legislative act are jointly and severally liable as a matter of law, and all payment obligations contracted out by Pemex before the effectiveness of the Pemex Charter will be honored. Now, instead of having only one debtor, the creditors have four more from which to seek relief for its loan exposure entered into before the issuance of the Pemex Charter. Furthermore, Pemex's reorganization did not entail a materially adverse change in its financial conditions. To the contrary, the restructure of Pemex will foster its financial health.110

The Pemex Charter expressly provides upon the agreement of the subsidiaries for the prospective joint and several liability of the subsidiaries with regard to Pemex's payment obligations. However, the law has always granted this right to any person.111 To reinforce this point, the Pemex Charter states that "Petróleos Mexicanos and the organismos subdiarios may be severally or jointly and severally liable for any national or international payment obligations."112

Finally, by operation of the Pemex Charter, its subsidiaries are subrogated in the rights and obligations of Pemex in accordance with the scope of activities assigned to them.113 Thus, upon the approval by Pemex's board of directors, all assets, properties, activities, functions, and personnel originally under the ownership, control, or management of Pemex should be transferred to the subsidiaries pursuant to their corporate purposes.114 Once Pemex formally transfers these assets, the subsidiaries will have constituted their own patrimony.115

C. THE BOARD OF DIRECTORS OF PEMEX

The new law provides that the board of directors will be the highest decision-making body in the petroleum industry. The Pemex Charter gives this power in spite of the authority legally granted to Pemex's sectoral head, the Ministry of Mines, Energy, and Parastatal Industry (commonly known by its Spanish acronym as SEMIP).116 Under Mexican administrative law the ministry regulates the "oil

112. Pemex Charter, supra note 6, art. 5.
113. Id. art. 7, Transitory Provision.
114. Saving provision article 6 of the Pemex Charter gives Pemex this tremendous task of fragmenting Pemex's properties and activities and transferring the corresponding assets and functions to the subsidiaries. This task shall be effected in a term not to exceed one year from the date of effectiveness of the Pemex Charter.
115. See also Pemex Charter, supra note 6, art. 5.
116. See Organic Law, supra note 20, art. 33, § VIII.

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industry, basic petrochemistry, mining, electricity, and the nuclear industry.\textsuperscript{117} 
Pemex and its subsidiaries are vested with a dual role: sole player in the petroleum industry of Mexico and the industry's most important regulator.\textsuperscript{118} This apparent contradiction of jurisdictions between an agency and a parastatal may be resolved by the fact that by operation of law the chairman of the board of directors must be the minister of the sectoral head of Pemex (SEMIP).\textsuperscript{119} 

Pemex's board of directors is composed of eleven members,\textsuperscript{120} of which six are presidential appointees. Currently, all of the members are cabinet members except one: the director general of the Comisión Federal de Electricidad (Federal Utilities Commission, another major parastatal, known by its Spanish acronym as CFE).\textsuperscript{121} The cabinet members are the Ministers of Finance and Public Credit, Commerce and Industrial Development, Foreign Affairs, Social Development (known by its Spanish acronym as SEDESOL, one of its most important functions being to protect the environment), and of course, the chairman of the board, SEMIP.\textsuperscript{122} The Petroleum Workers Union appoints the remaining five members of Pemex's board of directors.\textsuperscript{123} 

The board of directors is powerful not only because it is integrated by highly leveraged ministers, or because the Pemex Charter declares it the highest decision-making body of the petroleum industry in Mexico, but also because of the express power provided under article 10 of the Pemex Charter. Article 10 provides that all the necessary powers for the central administration and strategic management of all activities covered by the petroleum industry are exclusively reserved to the board of directors. This expressly includes: approving projects in accordance with national energy plans, planning and budgeting of the state

\textsuperscript{117} Id. This apparent contradiction ought to be resolved through Mexican construction rules. Both the Pemex Charter and the Organic Law of the Federal Public Administration are federal "secondary" legislations. As such, and in accordance with Mexico's supremacy clause, both legislations are on the same level. Accordingly, the former legislation should prevail in the event that we follow the axiomatic rule of construction of \textit{lex posterior derogat priori} or \textit{lex specialis derogat generalis}. 

\textsuperscript{118} "Petróleos Mexicanos shall be directed and managed by a Board of Directors which shall be the highest management body of the oil industry..." Pemex Charter, \textit{supra} note 6, art. 6. 

\textsuperscript{119} Id. art 7; \textit{see also} Parastatal Law, \textit{supra} note 10, art. 18; Regulations to the Parastatal Law, \textit{supra} note 10, art. 16, § 1. The appointment is strictly personal; no representation is allowed. The director general is barred from being a member of the board. As to the requirements and impediments in order to be eligible to the board, see Parastatal Law, \textit{supra} note 10, art. 19, and Regulations to the Parastatal Law, \textit{supra} note 10, arts. 14, 15. 

\textsuperscript{120} For each incumbent member, an alternate is appointed. \textit{See} Pemex Charter, \textit{supra} note 6, art. 7. 

\textsuperscript{121} The director general of Pemex is also a member of the board of directors of CFE. Currently, Pemex is the only supplier of the requirements that CFE has for fuel oil, natural gas, and gasoil. 

\textsuperscript{122} No requirement exists that the appointment of the board of directors of Pemex shall always fall upon the head of one of the cabinet members, except for the Ministry of Finance and the chairman of the board, who as already mentioned, must be the minister of the sectoral head of Pemex. \textit{See} Parastatal Law, \textit{supra} note 10, art. 19; Regulations to the Parastatal Law, \textit{supra} note 10, art. 17. 

\textsuperscript{123} They must be active members of the union and permanent workers of Pemex. \textit{See} Pemex Charter, \textit{supra} note 6, art. 7.
petroleum industry globally, and evaluating strategic objectives thereof;\textsuperscript{124} establishing policies and guidelines necessary to achieve a healthy economic and financial balance between the subsidiaries and affiliates, as well as permitting the proper handling and management of the assets that the Mexican federal government appropriates to the petroleum industry;\textsuperscript{125} and establishing or incorporating subsidiary corporations or affiliates that may perform those economic or social activities that are not exclusively reserved to the state (that is, the strategic areas).\textsuperscript{126} These express powers are meant to be illustrative and not exclusive.\textsuperscript{127} In any event, the jurisdiction and authority of Pemex’s board of directors and the directors of the subsidiaries will be defined when the President promulgates the regulations of the Pemex Charter.\textsuperscript{128}

Each of the subsidiaries has its own board of directors and a director general.\textsuperscript{129} The boards of directors of the subsidiaries are integrated by eight members with their corresponding alternates.\textsuperscript{130} The chairman of each board is the director general of Pemex.\textsuperscript{131} Four of their members represent the federal government of the United Mexican States and are appointed by the President. The other three members are the directors general of the other three subsidiaries.

Coupled with Pemex’s board of directors’ faculties are powers granted to the director general of Pemex, who is the chief executive officer of the entity. Among the powers that the director general has as CEO of Pemex is global review of the activities of the subsidiaries. Nonetheless, a surveillance office is set up in each

\begin{itemize}
\item \textsuperscript{124} Id. art. 10, para. 1.
\item \textsuperscript{125} Id.
\item \textsuperscript{126} Id. art. 10, para. 2. Pemex is finally taking an approach closer to world standards by decentralizing operations through the creation of affiliates. Although, arguably, legally unnecessary because such right has always been granted, the new Pemex Charter has expressly empowered Pemex to incorporate entities in order to participate in those areas that are not exclusively reserved to the state. Accordingly, Pemex is aggressively taking advantage of the situation in order to assist its modernization objectives. For instance, in the near future, medical services, aviation services, telecommunications, and international procurement will be decentralized by means of stock companies wholly owned by Pemex. \textit{See} Petróleos Mexicanos, supra note 77, at 123-29 (list of Pemex and subsidiaries’ affiliates); Sánchez and Bardacker, supra note 76, at 15.
\item \textsuperscript{127} Id. Pemex Charter, supra note 6, art. 10.
\item \textsuperscript{128} The Pemex Charter did not repeal the regulations of the previous Pemex Charter enacted in 1971, Reglamento de la Ley Orgánica de Petróleos Mexicanos [Regulations to the Organic Law of Petróleos Mexicanos], D.O. (Aug. 10, 1972). Currently, and until the executive branch issues the regulations applicable to the Pemex Charter, the 1972 regulations are effective inasmuch as they do not oppose or contravene the Pemex Charter. \textit{See} Pemex Charter, supra note 6, art. 3, Transitory Provision.
\item \textsuperscript{129} Pemex Charter, supra note 6, art. 8.
\item \textsuperscript{130} Id. art. 9.
\item \textsuperscript{131} Id. This might be a contradiction to article 18 of the Parastatal Law and article 16, section 1, of the Regulations to the Parastatal Law, which establish that the minister of the sectoral head of the corresponding decentralized public entity shall be the chairman of the board (of course, in this case we are talking about the same sectoral head: SEMIP). Perhaps we may find a response precisely on the innovative administrative term of subsidiary; thus, if such entities are acting as subsidiaries of Pemex, one may argue that the director general of the latter should be the chairman of the board of the former.
\end{itemize}
subsidiary. An official auditor (comisario público propietario), with its corresponding alternate (comisario suplente), must be appointed by the Federal Controller’s Office of Mexico (Secretaría de la Contraloría General de la Federación, known by its Spanish acronym as SECOGEF).\textsuperscript{132}

The President appoints the director general of Pemex.\textsuperscript{133} He is the most important legal representative of Pemex and, hence, of the petroleum industry of Mexico.\textsuperscript{134} The President also appoints the director general of each subsidiary,\textsuperscript{135} who acts as the legal representative of that subsidiary,\textsuperscript{136} and performs other duties as expressly delegated by the director general of Pemex.\textsuperscript{137}

The director general of Pemex must resolve any discrepancy or conflict among the entities with respect to their jurisdiction or scope of activity.\textsuperscript{138} The Pemex Charter will resolve many of the internal problems that now plague Pemex, its subsidiaries, and other domestic and international affiliates.

In order to fully modernize the Petróleos Mexicanos Group, one of the greatest challenges of Pemex, its subsidiaries, and its affiliates is precisely the internal adjustment that they must cope with as a consequence of Mexican legal reforms and the reorganization process. The challenge facing Pemex is that it must, by reorganization, restructuring, and paying greater attention to standard business practices, become more competitive, more quality conscious, and more efficient in the global petroleum industry. The proper allocation of activities and assets, and determining the boundaries of authority that the subsidiaries and affiliates must observe between each other, will be something that will require not only time, but also the proper political direction and coordination of Pemex.

\begin{itemize}
\item \textsuperscript{132} Pemex Charter, \textit{supra} note 6, art. 15.
\item \textsuperscript{133} \textit{Id.} art. 6.
\item \textsuperscript{134} In such capacity, he has by operation of law all of the powers that correspond to attorneys-in-fact under Mexican law, whether for lawsuits and collections, for administrative acts, or for ownership and disposition acts, as well as for those that require special provision in accordance with the first three paragraphs of article 2554 of the Federal Civil Code, along with other special powers as enlisted under article 12 of the Pemex Charter. These same powers are also conferred to the directors general of the subsidiaries. They will act to the extent permitted by the scope of activities assigned to their corresponding entities. Pemex Charter, \textit{supra} note 6, art. 6.
\item \textsuperscript{135} Pemex Charter, \textit{supra} note 6, art. 8.
\item \textsuperscript{136} See the express powers conferred to the directors general of the subsidiaries in the Pemex Charter, \textit{supra} note 6, art. 11.
\item \textsuperscript{137} Id. art. 12, para. 2.
\item \textsuperscript{138} Id. art. 13, § IV. The director general of Pemex is also exclusively empowered to: (i) prepare, with the participation of the subsidiaries, the planning and strategic budgeting of the oil industry as a whole and submit the same to the board of directors for its approval; (ii) prepare the financial programs of the industry, define the basis for the systems of supervision, coordination, control, and performance of the subsidiaries and affiliates for their joint operation, and the management of the common services to them; (iii) pursuant to the terms of section A of article 123 of the Mexican Constitution and of the Federal Labor Law, agree with the Petroleum Workers Union on the collective bargaining agreement and issue the labor regulations of the officials, which shall govern the labor relationships of Pemex and the subsidiaries. \textit{See} Pemex Charter, \textit{supra} note 6, art. 13.
\end{itemize}
IV. The Oil, Gas, and Petrochemical Industry Within the NAFTA

To this point the article has discussed the constitutional and federal regulations regarding the ownership of natural resources in Mexico. The key principle is very clear and simple: only the Mexican nation can own the hydrocarbons of Mexico's subsoil, and only Pemex and its subsidiaries may exploit them. But with the completion of the NAFTA, Mexico's petroleum industry will change. Once the Mexican Senate ratifies the NAFTA, and the ratification is published in the official gazette, the NAFTA will become the supreme law of the land.

The core and main objective of the NAFTA is not only free trade, but also direct investment. Many have argued that the monopoly of Mexico's petroleum industry as a strategic activity, exclusively reserved to the state, is a restraint on foreign investment. Moreover, the prohibition on granting contracts with a risk fee in kind (oil and gas participation among other things already described) is also deemed to be a restraint on foreign direct investment.

In spite of these limitations, under the NAFTA, North America will become one of the most important trading blocs of energy in the entire world. This commercial position will be jointly attained in spite of the fact that investment in certain energy sectors such as oil, natural gas, and basic petrochemicals is excluded under the investment chapter of the NAFTA. At the inception of the NAFTA negotiations all parties were fully aware that the Mexican Constitution was not going to be on the table for negotiation. To the contrary, the Mexican Constitution's supremacy clause clearly compels the NAFTA to be adjusted in accordance to the Mexican Constitution, not the Constitution adapted to the NAFTA.

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139. See Murphy, supra note 91, at 266.
141. MEX. CONST. art. 133.
142. See, e.g., Murphy, supra note 91, at 262-72.
143. In effect North America will have one of the largest trading blocks in the natural resources sector by having the United States as the second largest oil producer of the world, Mexico as the fifth, and Canada as the thirteenth. Pemex is the fourth largest enterprise in the world oil industry, after Shell, Exxon, and British Petroleum. Pemex is the third largest company in the world, in terms of its equity base, only after Shell and IBM. It is the sixteenth largest corporation in the world in terms of its assets, and the fifth largest in the oil business, after Shell, Exxon, British Petroleum, and ENI. See Sara Hammes & Richard Teitelbaum, How They Performed in 1990, FORTUNE, July 29, 1991, at 238. Pemex as a corporation currently ranks number three in the world in crude oil and condensates production. See Oil Production Triggered by Crisis Stays on Steam Throughout '91, OIL & GAS J., Dec. 30, 1991, at 43. Pemex is also the third largest as measured by the composite index (a combination of reserves, output, refining capacity, and product sales by volume). See PETROLEUM INTELLIGENCE WKLY., Dec. 23, 1991. It should be remembered that Mexico is not a member of the Organization of Petroleum Exporting Countries.
144. See, e.g., Stan McLelland, Executive Vice President and General Counsel of Valero Energy Corporation, Business Implications and Legal Rules for the World's Largest Common Market, Remarks at Conference Sponsored by the American Institute 4.
145. See MEX. CONST. arts. 133, 15; see also Vázquez Pando, supra note 68, at 35.
A. DISPARITIES AND SIMILARITIES OF THE THREE INDUSTRIES

All parties to the NAFTA were aware of the disparities in the structure and function of the oil and gas industry in each country. As such, opening the oil and gas industry in Mexico was never a condition for the economic integration of North America. The dissimilarities in the petroleum industry in the United States, Mexico, and Canada were always known. The rationale to integrate in the energy sector was to accomplish a complementary adjustment of the three industries in order to form a unified and powerful trading block.

In the United States, for instance, private ownership prevails in the production, development, and distribution of oil and gas. The United States does not have a state-run oil company. The whole spectrum of the energy sector of the United States, however, is a combination of public, quasi-public, and private activity. The federal and some state governments have conserved limited ownership of natural resources of some lands. Few public utilities companies exist because the oil and gas industry is largely controlled by privately owned companies. Furthermore, the U.S. petroleum sector has a diversified market compounded by a competitive and decentralized industry.

Canada, on the other hand, significantly follows the same pattern of a mixed economy as Mexico, although Mexico has a more pronounced state intervention in the energy sector. While the Canadian Government virtually leaves the production and marketing of energy products to private players, meaningful participation lies with federal and provincial governments as to holding interests in some business ventures in the oil and gas industry. For instance, Canadians have the so-called crown corporations at the federal and provincial level. Nevertheless, the Mulroney administration initiated sweeping reforms and moved towards

146. See, e.g., Thad Grundy, former Deputy Assistant Secretary for International Affairs, U.S. Dept of Energy, Remarks at the University of Texas School of Law Seminar, Planning for North American Free Trade, Mexico City (July 9 & 10, 1992).

147. An understanding of this topic, however, requires much more than an analysis of economic data such as production and price. The political and cultural significance of oil in Mexico is not understood by most Americans, but has a fundamental bearing on the way Mexico approaches energy issues, and in particular foreign participation in the energy sector.


149. "The preference for private enterprise in energy is... a matter of Congressional choice rather than Constitutional mandate." Id.


151. Petro-Canada is the best-known at the federal level. Petro-Canada was incorporated in 1975 as a reaction to Canada’s reliance on foreign energy and the growth of foreign participation in the oil industry. Although it was not privatized by the former conservative government, Petro-Canada’s activities have been limited or abolished. Many other crown companies at the provincial level have been privatized. Id. at 117-18.
privatizing governmental energy enterprises, deregulating oil pricing and marketing, and opening Canada to more foreign investment.152

B. THE OIL, GAS, AND PETROCHEMICAL INDUSTRY WITHIN THE NAFTA

Despite the major role that the energy sector played in the U.S.-Canada Free Trade Agreement (FTA), the same has not been the case for the NAFTA. The NAFTA negotiations have primarily focused on free trade in the natural resources sector, not with regards to the free flow of investment in that energy sector.

Chapter IX of the U.S.-Canada FTA shields Canada from embargos and import duties and protects the United States from export prices and other export restrictions.153 Within the investment rules the parties agreed to give other nationals no less favorable treatment than domestic investors. This method has not been envisioned for the NAFTA. Hence, the exclusion of the oil, gas, and basic petrochemical industry within the NAFTA rules of investment was not critical for the success of the trilateral talks.154

In chapter XI, the investment chapter of the NAFTA, article 1108, exhibit III, the parties agreed, upon Mexico’s reservation, to exclude the oil, gas, and basic petrochemical industry, including as expected all the activities comprised within the petroleum industry. With respect to energy and basic petrochemicals, chapter VI of the NAFTA, the parties deferred to each member state’s constitution, thereby agreeing to Mexico’s reservation and exclusion of the Mexican petroleum industry.155

As in the FTA, little immediate effect on trade in the energy sector of North America is expected. Canada, the United States, and Mexico have been trading in a competitive environment for years,156 and already have taken measures to overcome barriers to trade in energy commodities. Similarly to the FTA, the NAFTA promises long-term stability in trade and ensures an adequate supply of energy products among the three nations.157 However, Mexico did not accept the “proportional access” clause (energy security and supply provision), as provided in the FTA.158

153. Import prices, however, can be used for the enforcement of antidumping and countervailing duties. See Murphy, supra note 91, at 267-68.
154. See Saunders, supra note 152, at 266.
155. See NAFTA, supra note 56, art. 601(3), annex 602.3(1)(a)(b).
156. See DWARKIN, supra note 86, at 71-72.
157. In accordance with article 603, annex 608.2(1)(2) of the NAFTA, Canada and the United States agreed to observe exhibits 902.5 and 905.2 of the FTA and the Agreement on an International Energy Program.
158. See Colleen Morton & Joseph Greenwald, A Preliminary Analysis of the North America Free Trade Agreement, Remarks at the U.S. Council of the Mexico-U.S. Business Committee 13 (Aug. 21, 1992). The reader should bear in mind that Canada had already committed itself to a similar obligation as provided under the proportional access clause of the FTA, when it signed the International Energy Agreement. See DWARKIN, supra note 86, at 77.

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GATT provisions were reasserted within the proposed energy and basic petrochemicals chapter of the NAFTA. Accordingly, quantitative restraints, minimum or maximum export-price requirements, and except as permitted for the enforcement of countervailing duties and antidumping measures, minimum or maximum import-price requirements are prohibited. If a restriction on imports is to be imposed by one of the parties, the parties shall consult and try to avoid undue interference in price, marketing, and distribution. Dual pricing for internal and external consumers will be gradually eliminated. As already covered by article XVII of the GATT, Pemex and its subsidiaries, as state enterprises, are called to transact and behave under commercial considerations. Moreover, the procurement chapter of the NAFTA has been seen as a promising sign especially for the U.S. equipment and oil field service companies that have suffered domestically.

159. "The most positive impact of the energy chapter is probably the fact that Mexico has now for the first time in many years opened the door to limited foreign investment. This development, coupled with the restructuring of Pemex and the need for foreign capital and technology, should mean greater opportunities in the future for U.S. participation in Mexico's energy sector." Grundy, supra note 66, at 10; see also Alejandro Alvarez Bejá, El TLC, Estratégico en la Privatización del Sector Energético Mexicano, EL FINANCIERO, Jan. 18, 1993, at 35a. But see Rebeca De Gortari, En Entredicho, el Futuro de la Industria Petrolera, EXCELSIOR, Mar. 12, 1993, at I-I.

160. See NAFTA, supra note 56, art. 603(2).
161. Id. arts. 301, 606(a).
162. See id. ch. XV, Competition Policy, Monopolies and State Enterprises. Overlooked by sociologists, politicians, and lawyers are the consequences of the undertaking already assumed by the Mexican Government since its accession to the GATT and the adoption of chapter XV of the NAFTA. In Mexico the theme of empresa pública, state enterprise, is a highly debated concept and a subject that remains open to discussion by sociologists and politicians. For many scholars and government policymakers, even those working in the ruling party, the main purpose of a state enterprise is not necessarily to be a profit center ruled by commercial considerations. Regardless of the personal opinion of the author, with the assumption of the above compromises, future administrations are virtually constrained and are bound to observe the underlying principle of the NAFTA: a free market. The coming generations shall be very cautious in implementing their policies and shall refrain from breaching or departing from the principles embodied in such provisions. Interesting, however, is the state enterprise definition adopted by the parties, which only considered the concept of control and ownership of shares of the state company. NAFTA, supra note 56, art. 1505. As mentioned before, under Mexican law there are other types of state enterprises that do not contemplate the concept of control or ownership of stock. Pursuant to Mexican administrative law, ownership and control of the outstanding shares of a corporation is one of several ways that the law finds to determine that a company is a public instrumentality (parastatal). There are other entities that are parastatals (state enterprises) that do not have shares. They include trust funds and decentralized public entities such as Pemex and its subsidiaries and the Comisión Federal de Electricidad. Decentralized public entities do not have stock, equity, stated capital, or any other type of title of ownership. These parastatals are created by an act of Congress or by an executive decree. See Organic Law, supra note 20, art. 45; see also supra text accompanying note 20.
163. See McLelland, supra note 144, at 8. Mexico is not a party to the Agreement on Government Procurement entered into force after the Tokyo Round (GATT procurement chapter). Nevertheless, with the procurement chapter of the NAFTA, domestic procurement preferences will be abolished in a term not to exceed ten years, including, of course, the acquisitions of Pemex and the CFE, the two major parastatals in the energy sector of Mexico. For further review, see Grundy, supra note 66, at 8-13; Barshefsky & Lichtenbaum, Government Procurement Provisions of the North American Free Trade Agreement, Remarks delivered at the American Bar Association's Conference, The North American Free Trade Agreement: Its Scope and Implications for North America's Lawyers, Businesses and Policymakers, Washington, D.C. (Jan. 27 & 28, 1993).
By making a global analysis of the NAFTA’s chapters on investment, energy and basic petrochemicals, procurement and competition policy, and monopolies and state enterprises, substantial changes have been made to Mexico’s oil, natural gas, and petrochemical industry. These changes will be realized without affecting the Mexican constitutional and juridical requirements concerning the petroleum industry. With the conclusion of the NAFTA and Mexico’s internal reforms, Pemex will be in a better position to modernize its operations.