Decree That Amends and Supplements Various Provisions of the Regulatory Law of Constitutional Article 27 in the Field of Petroleum

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On April 29, 1995, the above referenced decree (the Decree) was passed by the Mexican Congress. The Decree was published on May 11, 1995 in the Diario Oficial de la Federación, and entered into force on May 12, 1995.

While reaffirming that petroleum exploration, exploitation and production continue to be reserved exclusively to the State, the Decree does permit the private sector to transport, store and distribute gas. Specifically, while the exploration, exploitation and first sales of gas are reserved exclusively to the State, the transportation, storage and distribution of gas, together with the construction, operation and ownership of pipelines, installations and equipment, may now be pursued by the private sector. The Decree also sets forth the basic items that must be submitted to obtain authorization to conduct such activities.

Pursuant to the Decree, Mexico oil and gas interests will be transferred to Petroleos Mexicanos (PEMEX) for administration, under the supervision of the Secretary of Energy. The Decree also sets forth procedures for obtaining access and right of way over privately owned and ejido lands, and includes provisions for PEMEX to indemnify such parties for harm to their lands. The Decree requires PEMEX to compete with the private sector on an equal basis in its future gas transport, storage and delivery activities.

The Decree also provides that the petroleum industry, and those sectors of the industry that the Decree opens to private participation, shall be under the exclusive Jurisdiction of the federal government. As a result, only the federal government will have the authority to issue technical norms and regulations addressing the oil and gas industry.

The following is an unofficial English translation of the Decree, beginning with the Decree’s preliminary article of purpose (exposición de motivos) as stated by the President to Congress, and followed by its text:

1. This unofficial translation is provided by Franck, Galicia, Duclaud y Robles, S.C., Mexico City, for convenience only, and should not be relied upon as an official translation of the subject law.
Our national design, explicit in the General Constitution of the Republic, establishes the inalienable and non-prescriptive dominion of the Nation over petroleum and all the solid, liquid or gaseous hydrocarbons existing in mantles, fields and mineral beds in the national territory, including the continental shelf.

This principle, with a solid legal, political and economic basis, is related to the permanent purpose of the preservation of the national sovereignty and the objectives of development and well being. It is, for this, a principle that all Mexicans understand, share and support.

In observance of the constitutional mandate, the petroleum industry — that among its other activities includes the exploration and exploitation of gas — has entrusted to Petroleos Mexicanos and its subsidiary organizations, as public organizations through which the Nation carries out the exploitation of hydrocarbons, the exercise of the exclusive rights that the Constitution grants.

One finds Mexico immersed in a process of structural change, oriented to elevate the competitiveness of the productive sector, create permanent employment and improve wages, and elevate the quality of life of its people. The energy sector is a key piece in this process, in that it provides basic inputs to all productive processes. In actuality, in addition to carrying forward the modernization of petroleum activities, it is indispensable to develop a gas industry that insures a sufficient, timely and competitive supply of clean fuel to satisfy the demands of the productive sector and of the generation of electric power, and that increases the availability of raw materials for the manufacturing of petrochemicals. A rapidly expanding gas industry, together with the increase in the availability of reserves on which the Country depends, would notably stimulate investment and employment.

The utilization of hydrocarbons, above all of petroleum, has been one of the principals impelling the industrial unwinding of Mexico. The gas industry must complement this contribution in a dynamic way. The development of the Country requires its strengthening, through a rational, ordered and opportune utilization both of associated gas that, in 1994, represented more than four-fifths of the Country’s total gas production, as well as of dry gas. The availability of reserves and the forecast for demand calls for vigorous development of the Country’s gas fields.

A rapid growth in the internal demand for gas is expected, especially from 1998, when environmental protection regulations enter into force that require that gas be substituted, in environmentally critical areas, for the fuel oil utilized in the generation of electric energy. On the other hand, the growth and competitiveness of the industry demand the timely supply of this fuel and the availability of gas as a raw material for industrial processes. This growing demand for gas would have to be satisfied through importation, if actions oriented toward establishing in Mexico a modern and competitive gas industry are not commenced immediately.
In effect, Mexican regulations with respect to ecological matters after 1998 will compel a drastic reduction in the utilization of fuel oil in the generation of electric energy, or the use of fuel oil for this purpose only, with almost no sulphur content. The petroleum industry will have the opportunity, by refraining from producing fuel oil, to gain value and efficiency in the refinement of other petroleum products. Compliance with environmental regulations and the modernization of the refinement process will only be possible with reliance on a sufficient supply of gas as a substitute for fuel oil. If not, it will be necessary to dedicate considerable resources to the importation of gas or clean fuel oil, or to process it internally, with high costs and lower profitability for the domestic petroleum industry.

International experience indicates that the availability of gas, in sufficient volumes and competitive prices, generates a vast chain reaction in diverse industrial sectors, as much in those that make use of consumption, especially in the case of secondary petrochemicals, as in those that utilize it as the most convenient industrial fuel in terms of cost and operating conditions. As has occurred in other countries, this availability can be the spark that increases the industrial transformation process and the substantive improvement of the international competitive capacity of Mexican industry.

Additionally, the operation of a vigorous gas industry will permit the exportation of excess production. In the presence of the expected decline in some of the traditional areas of production, one can foresee the conversion of Mexico into an important exporter of gas in the North American regional market.

_Petroleos Mexicanos_ and its subsidiary organizations — especially _Pemex Exploracion y Produccion_ and _Pemex Gas y Petroquimica Basica_ — are important pieces in the development program for the gas industry in Mexico. To them belong the strategic activities of exploration, exploitation and processing of gas. The attention and resources of Pemex must be concentrated in these activities, which will fall on them to be carried out in an exclusive manner.

Another central element to this program is the participation of the private and social sectors in the related activities of transportation, storage and distribution of gas. From this participation, important contributions by way of investment in material and resources; modern technologies for pipeline and distribution system operations, including instrumentation and mechanisms of measurement and control are expected. These complementary contributions would permit the concentration of public resources in the strategic segment of the gas industry.

There would be attained, in this way, a dynamic compilation: the State organization, with full attachment of the Constitutional provisions, would exercise the State prerogatives as owner of the resources, controlling and operating, with exclusivity, the exploration, the exploitation and the processing of gas, at the same time that individuals would be able to invest in installations for the transportation, storage and distribution of this fuel. The healthy development of the gas industry requires the strengthening of these related activities, in order to permit the better utilization of production and to make it available to users in a timely, sufficient and competitive form.

One must also count on the participation of the private sector to facilitate the distribution of gas for domestic use through low pressure pipelines, which replace the scheme of surface distribution by way of tanks and containers, which involve risks, result in inefficiencies and have secondary effects on vehicular traffic and environmental contamination.

The activities related to transportation, storage and distribution of gas must be accomplished in conformance with regulations that assure their efficiency and competitiveness.
and which permit their general development in an indiscriminate way and with equitable conditions for all users.

In the initiative for amending and supplementing the Regulatory Law of Constitutional Article 27 in the Field of Petroleum submitted for your consideration, the following is sought:

1. To reaffirm the strategic character, exclusive to the State, of the exploration, exploitation and production of gas, as well as the activities of transportation, storage and distribution that are inherent in said activities.

2. To define with clarity the transportation, storage and distribution of gas, to permit the participation of individuals in the construction, ownership and operation of pipelines and other installations, subject to the regulatory standard that this law and its regulatory provisions establish.

3. To establish the scope and content of this regulatory standard, to guaranty its operation in efficient and competitive conditions, as well as to improve utilization of its services and products for the end user.

4. To give the character of public interest to the activities of gas pipeline construction.

5. To promote private participation in the activities of transportation by gas pipelines, to construct new fields of investment and employment and to strengthen the gas industry and productive activity in general.

It is the intention of the Federal Executive that Petroleos Mexicanos preserve the gas pipeline property that it actually owns, subjecting those that it subsequently utilizes for transport for first sales of products to the general regulations for activities of this character, guarantying competitiveness with other economic agents that intervene in this service.

Based on the foregoing the following amendments and supplements to the Regulatory Law of Constitutional Article 27 in the Field of Petroleum are proposed:

a) To modify Article 3, in order to establish with greater clarity the different activities that comprise the petroleum industry and to state precisely the activities of transportation and storage of gas that form a part of it.

b) To modify Article 4, preserving the exploitation of the petroleum industry and its three branches as strategic activities according to the terms of Article 28, Paragraph four of the Constitution and ratifying the exclusivity for the Nation of its exploitation by Petroleos Mexicanos and its subsidiary organizations. To supplement the same Article 4, in order to define as activities susceptible to operation by the public, social and private sectors, the transportation, storage and distribution of gas, subjecting them to the direction of the State and the regulatory provisions and the regulations that it issues for this purpose.

c) To modify Article 9, in order to indicate that the activities referred to in Article 4 are, like those of the petroleum industry, subject exclusively to federal jurisdiction and, as a consequence, the exclusive competence of the federal government to issue technical regulatory provisions and the regulations that govern them. To eliminate from this provision the reference to the exclusivity of the federal government to establish the taxes imposed on any of its aspects whatever, by
virtue of which, in the standard of the National System of Fiscal Coordination (Sistema Nacional de Coordinación Fiscal), they may be subject to certain obligations of a State and Municipal character in the terms of the respective local legislation.

d) Define in Article 13 the objectives, area and scope of the regulatory standard to which the activities of transportation, storage and distribution of gas will be subject.

e) To establish in Article 15 the jurisdictional competence in the application of the law.

Finally, the modification of the method of sanctions applicable to infractions of the Law and its Regulations is proposed, fixing the amounts in indexes that permit their automatic updating; likewise, the denominations of public agencies shall likewise be updated in conformance with the Organic Law of the Federal Public Administration (Ley Orgánica de la Administración Pública Federal) in force and the scope of the supplemental application of the provisions of the Civil Code in such matters.

By the foregoing expression and based on the provisions of Section I, Article 71 of the Political Constitution of the United Mexican States, by the honorable conduct of Citizen Secretaries, permit me to submit for the consideration of the Honorable Congress of the Union, the following Initiative of: Decree...”

The following is a translation of the Decree, as published on May 11, 1995 in the Federal Official Gazette (Diario Oficial de la Federación)

(In the margin, the seal with the National Emblem that says: United Mexican States.- Presidency of the Republic.)

ERNESTO ZEDILLO PONCE DE LEON, Constitutional president of the United Mexican States, lets it be known to its people

That the Honorable Congress of the Union has directed me as follows

Decree

"THE CONGRESS OF THE UNITED MEXICAN STATES, DECRESSES:

THE AMENDMENT AND SUPPLEMENT TO VARIOUS PROVISIONS OF THE REGULATORY LAW OF CONSTITUTIONAL ARTICLE 27 IN THE FIELD OF PETROLEUM

ARTICLE SOLO.- Articles 3, 4, 5, 7, 9, 10, 12, 13, 14, 15 and 16 of the Regulatory Law of Constitutional Article 27 in the Field of Petroleum, are amended and supplemented in order to read as follows:
"ARTICLE 3o.- The petroleum industry includes;

I. The exploration, the exploitation, the refining, the transport, the storage, the distribution and the first sales of petroleum and the products that are obtained from its refinement.

II. The exploration, the exploitation, the manufacturing and the first sales of gas, as well as the transport and the storage indispensably interconnected with its exploitation and manufacture.

III. The manufacture, the transport, the storage, the distribution and the first sales of those derivatives of petroleum that are susceptible to serve as basic industrial raw materials, and these gas derivatives which constitute basic petrochemicals.

ARTICLE 4o.- The Nation will develop the exploration and exploitation of petroleum and the other activities that are referred to in article 3o., which are considered strategic pursuant to the terms of article 28, paragraph four, of the Political Constitution of the United Mexican States, by means of Petroleos Mexicanos and its subsidiary organizations.

Save that set forth in article 3o., the transport, storage and distribution of gas may be carried out, with prior permission, by the social and private sectors, which may construct, operate and own pipelines, installations and equipment, within the terms of the regulatory and technical provisions and regulations that are issued.

ARTICLE 5o. — The Secretary of Energy will assign to Petroleos Mexicanos those lands that the institution requests or that the Federal Executive considers proper to assign to it for purposes of petroleum exploration and exploitation.

The Regulation of this Law will establish those cases in which the Secretary of Energy would be able to refuse or cancel the assignments.

ARTICLE 7o.- The inspection and the surface exploration of the lands in order to investigate their potential for petroleum, shall only require the permission of the Secretary of Energy. If there is opposition by the property owner or party in possession when the lands are privately owned, or of the legal representatives of constitutionally created communal farms (ejidos) or communes, when the lands are affected by the constitutional communal farm (ejidal) or communal system, the Secretary of Energy, hearing the testimony of the parties, shall grant permission via an acknowledgment made by Petroleos Mexicanos of the obligation to indemnify those affected from injuries and losses that they might suffer, in accordance with the report of an expert that the Commission for the Valuation of National Property (Comisión de Avalúos de Bienes Nacionales) made within a time frame that shall not exceed six months, with Petroleos Mexicanos able to deliver an advance payment, in consultation with the same Commission. The remainder of the payment will be settled once the expert's report is completed.

ARTICLE 9o.- The petroleum industry and the activities that are referred to in article 4o., second paragraph, are of the exclusive federal jurisdiction. As a consequence, only the Federal Government is able to dictate the technical and regulatory provisions, and governing regulations.
ARTICLE 10.- The petroleum industry is for the benefit of the public, having priority over any exploitation and development whatsoever of the surface or subsurface of the lands, including over the tenancy of the constitutionally created communal farms (ejidos) or communes and the temporary or definitive occupation or expropriation of same shall be available, by means of legal indemnification, in all cases that the Nation or its petroleum industry require.

Gas pipelines construction activities are of public interest. Petroleos Mexicanos, its subsidiary organizations and the social and private sector companies shall be obligated to provide gas pipeline transport and distribution services to third parties, with the exceptions and subject to the terms and conditions that are established in the reglamentary provisions.

ARTICLE 12.- In that not foreseen by this law, the acts of the petroleum industry and the activities referred to in article 4o., second paragraph, shall be considered as mercantile acts, governed by the Code of Commerce and, in a supplemental manner, by the provisions of the Civil Code for the Federal District in matters of local jurisdiction and for all the Republic in federal matters.

ARTICLE 13.- Those interested in obtaining the authorizations referred to in the second paragraph of article 4o. of this Law, must present a request to the Secretary of Energy which shall contain: the name and domicile of the applicant, the services that it desires to provide, the technical specifications of the project, the programs and commitments for investment and, if applicable, the documentation that proves its financial qualification.

Authorizations may be assigned with the prior authorization of the Secretary of Energy, and provided that the assignee meets the requirements to possess the authorizations and agrees to comply with the terms of the obligations set forth in such authorizations. In no event may an authorization, the rights conferred by it or the goods affected by same, be assigned encumbered or transferred to a foreign state or government.

Authorizations may be revoked for any of the following causes:
I. Failure to exercise the rights conferred in the authorization during the term established therein;
II. Suspension, without just cause, of the services the subject matter of the authorization given by the Secretary of Energy;
III. Conducting discriminatory practices to the prejudice of users, and violating the prices and tariffs that, as applicable, are set by competent authority;
IV. Assigning, encumbering or transferring the authorization in contravention of that set forth in this Law; and
V. Failure to comply with official Mexican standards, as well as those established in the authorization.

Recipients of authorizations are obligated to allow access to their facilities to examiners of the Secretary of Energy, as well as to provide the Secretary of Energy all the information that it requires to prove compliance with the obligations under its charge.

ARTICLE 14.- The regulation of the activities that are referred to in article 4o., second paragraph, and of the sale of gas in the first instance, shall have as its purpose to assure its efficient supply and shall include:
I. The terms and conditions to:
   a) The granting, the transfer and the revocation for non-compliance of authorizations;
   b) Sales in the first instance;
   c) The provision of transport, storage and distribution services;
   d) The non-discriminatory access and the competitive conditions of the transport, storage and pipeline distributions systems; and
   e) The presentation of sufficient and adequate information for the purposes of regulation;
II. The determination of the applicable prices and tariffs, when effective competitive conditions do not exist, in the judgment of the Federal Competition Commission (Comisión Federal de Competencia). The social and private sectors shall be able to request of said Commission that it declare the existence of competitive conditions;
III. The procedure for public consultation for the definition of the criteria of regulations, as applicable;
IV. The inspection and oversight of the compliance with the conditions established in the authorizations and applicable official Mexican regulations;
V. Those settlement and arbitration procedures to resolve controversies over the interpretation and compliance with contracts, and the procedure to challenge the refusal to execute them; and
VI. Such other instruments of regulation that the applicable provisions establish.

ARTICLE 15.- The violations of this law and its regulatory provisions may be enforced with fines of 1,000 to 10,000 times the amount of the general minimum wage in effect in the Federal District, as of the date of the occurrence of the violation, in the judgment of the competent authority, taking into account the seriousness of the violation.

ARTICLE 16.- The application of this law falls on the Secretary of Energy and, to the extent it of its competence, on the Energy Regulatory Commission, within the terms of the regulatory provisions.¹

TRANSITORY PROVISIONS

FIRST.- This Decree will enter into force the day following its publication in the Diario Oficial de la Federación.

SECOND.- All provisions that are inconsistent with those established in this Decree are superseded.

THIRD.- Petroleos Mexicanos will maintain in proprietorship and will maintain in operating condition the pipelines and their accessory equipment and installations for the transport of gas referred to in article 4, second paragraph, that actually form a part of its property, subjecting its operations to this law and to the reglamentary and technical provisions and the regulations that are issued. Likewise it shall continue performing gas transport activities with other equipment that make up its property, subjecting them to applicable provisions.
FOURTH.- The regulatory provisions will be issued within 180 days following the date that this Decree enters into force. Regulations shall be established for each type of gas or combination thereof.

Mexico, Federal District, April 29, 1995.-

Deputy Sofia Valencia Abundis, President.-
Sen. Martha Lara Alatorre, President.-
Deputy Manuel de Jesus Espino Barrientos, Secretary.-
Sen. Juan Fernando Palomino Topete, Secretary.- Signatures".

In compliance with the provisions of section I of Article 89 of the Political Constitution of the United Mexican States, and for its due publication and observance, I issue the present Decree in the residence of the Federal Executive Power, in Mexico City, Federal District, on the tenth day of the month of May of nineteen hundred and ninety five.

Ernesto Zedillo Ponce de León. Signature.-
Secretary of the Government, Esteban Moctezuma Barragán.- Signature.
A Guide to International Joint Ventures

by Ronald Charles Wolf,
Member of New York Bar; Member of Vermont Bar, USA

This book is a practical guide to international joint ventures. It undertakes to explain to lawyers, entrepreneurs, managers, economists, to all students and practitioners of international trade, the fundamentals which constitute an international joint venture. Furthermore, it highlights the documents needed, the essential clauses and some discussion of the protection of minority rights, as often joint venture equity participations are not equal. To some degree, the word 'international' is superfluous, for the ideas presented are also applicable to joint ventures between entities from the same country.

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