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The President of Mexico submits to Congress an initiative to amend the Hydrocarbons Law

On March 26, 2021, the President of Mexico submitted to the Chamber of Representatives (*Cámara de Diputados*) of the Mexican Congress an initiative (the “Initiative”) to amend the Hydrocarbons Law (“HL”). Before it may become effective, the Initiative would need to be discussed and approved by a majority vote in both chambers of the Mexican Congress.

From a reading of its introductory explanatory statements, it would appear that the primary objective of the Initiative is to strengthen the participation of Mexico’s state-owned companies in the oil downstream products market, particularly in the gasoline and diesel markets, however if the Initiative is approved in its terms, it could also affect all other activities regulated under the HL, including regulated activities related to crude oil, natural gas and petrochemicals.

The Initiative seeks to (i) require permit holders to comply with storage policies issued by the Ministry of Energy (“SENER”), (ii) modify the processing of requests made by permit holders for authorization to assign their permits granted under the HL, (iii) revoke permits when their beneficiaries carry out illicit trade with, and improper measurement of, hydrocarbons and petroleum products, and (iv) grant authority to temporarily suspend permits when in the presence of an imminent danger to national security, energy security or to the national economy. The Initiative proposes the following amendments to the HL, which seek to:

- Include as a new requirement for the granting of permits under the HL that the applicants demonstrate having the necessary storage capacity determined by SENER from time to time, and also include provisions in the HL so as to enable the government to revoke permits granted under the HL when their holders do not meet the minimum required storage capacity determined by SENER when the proposed amendments to the LH become effective. It should be noted that as of this date, SENER has only issued two storage policies: the Policy regarding Minimum Storage of Petroleum Products and the Policy regarding Natural Gas Storage, with the latter currently being only applicable to the National Natural Gas Control Center (“CENAGAS”); however it should be pointed out that SENER has the authority to modify the existing storage policies or issue new policies in relation to any kind of hydrocarbons, petroleum products or petrochemicals, so this new requirement could have a broader scope of application and extend not just to SENER’s current storage policies but to future ones as well.
- Modify the processing of requests for the assignment of permits granted under the HL so that if SENER and the Energy Regulatory Commission (“CRE”) fail to respond to any such requests within the required legal timeframe, the request for assignment in question be deemed rejected instead of deemed approved as it is currently the case under the HL as presently in effect.

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- Include as additional grounds to revoke any permit granted under the HL (i) the carrying out of transportation, storage or distribution activities in respect of, or selling to the general public, hydrocarbons, petroleum products or petrochemicals when any such products have been acquired illegally or as a result of the commission of a crime, as determined in a final ruling by an authority having competent jurisdiction, and (ii) being a repeat offender of applicable provisions setting out quantity, quality and measurement standards in respect of hydrocarbons and petroleum products, or being a repeat offender when modifying technical conditions of systems, pipelines, facilities or equipment without prior government authorization. These conducts may already lead to the imposition of penalties under the LH as currently in effect, but the Initiative seeks to establish that they also be grounds for the revocation of permits.
- Enable SENER and CRE to suspend any permit granted under the HL, for such length of time as they may deem appropriate, when in the presence of an imminent danger to national security, energy security or to the national economy and also enable SENER and CRE to manage and operate the business of the permit holder during the permit suspension period. To that end, the Initiative provides that SENER and CRE may carry out such management and operation during the permit suspension period through the permit holder's own personnel or through a new operator appointed to that effect (which could be any state-owned company) or through a combination thereof. The Initiative and the LH are silent as to the legal meaning of "imminent danger", "national security", "energy security" and "national economy" for purposes of declaring a permit suspension. Such concepts are eminently broad and may lead to different interpretations and even to their arbitrary application by SENER and CRE.

In this regard, it should be noted that, although the HL already provides similar government intervention powers (temporary government occupation of property, rights or facilities, and government intervention in the provision of services), said powers (i) apply, in the case of government occupation of property, rights or facilities, only for such reasons as set forth in the Expropriation Law (*Ley de Expropiación*) or when the permit holder fails to comply with its obligations for reasons beyond its control (such as in the case of war, natural disaster, riots or when in the presence of imminent danger to national security, energy security or to the national economy) and, in the case of government intervention, when the failure by a permit holder to comply with its obligations may result in serious danger to the supply of hydrocarbons, petroleum products or petrochemicals, (ii) may be exercised for a limited period of time not exceeding 36 months, and (iii) may only be exercised through legal entities and persons having the technical capacity and experience in the management and control of facilities of the kind as those that are the subject of the exercise of such government occupation and intervention powers.

The new permit suspension powers that the Initiative seeks to introduce in the HL do not require that the permit holder be in breach of its permit obligations, and such powers (i) may be invoked and exercised when the government considers that an event leading to "imminent danger", as referred to in the previous paragraphs, is taking place, (ii) are not limited in time (they could even be invoked and exercised for an indefinite period of time exceeding 36 months), and (iii) do not require that the government select legal entities and persons with technical capacity and experience to manage and operate the facilities of the permit holder, as a prerequisite to the exercise of such powers during the permit suspension period, situation that could compromise the safety of such facilities if they are managed and operated by persons lacking such technical capacity and experience during the permit suspension.

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Furthermore, it is important to mention that the Initiative provides that:

- (i) permit holders affected as a result of the enactment of the Initiative, may request, within the applicable legal framework, the payment of damages caused as a result thereof, which seems to justify the grant to the government of the proposed new permit suspension powers, and
- (ii) permits will be revoked when their holders, upon the entry into force of the proposed amendments to the HL, do not meet applicable legal requirements set out in the HL (including those related to minimum storage) or are found to be in breach of the provisions of the HL.

We are reviewing the possible implications of the Initiative, including possible defense strategies and legal challenges that could be considered by market participants who may be adversely affected if the Initiative is implemented. We will monitor the legislative discussion and enactment process in the Mexican Congress in respect of the Initiative, and will keep our clients informed of developments.

We invite you to reach out to your usual contacts at Ritch Mueller to discuss any particular situation regarding the Initiative, its specific potential adverse consequences and possible defense strategies. Alternatively you may contact us at contacto@ritch.com.mx so that we may direct your concerns to the appropriate members of our team.

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