

Mexico: Energy Reform 2013



Currently, Mexico is going through a critical period regarding the clear need for enactment of economic/legal reforms that allow international highlight, one such case is precisely the energy reform.

The President, Enrique Peña has decided to submit for consideration of the Congress, an initiative for constitutional amendments aimed at pursuing economic acceleration for the country through the structural reform of two sectors: oil and gas, as well as electric power.

Oil and Gas

- Regarding exploration and production (E&P), the proposed initiative tends to give a major economic boost to the country looking forward to produce its hydrocarbon resources and having competitive prices.
- E&P has become more expensive in recent years. While it is estimated that Mexico has reserves for 10 years, it will be necessary to confirm the existence of reserves and prospective resources, and eventually turn them into production.

- In terms of E&P, another challenge is to increase the recovery factor of mature fields, it is also important to develop new technologies in order to look for deep waters E&P.

Relevant fact: in 2012, Mexico had a daily production of 2.5 million barrels of crude oil and refined only 1.2 million barrels a day, having to import about half of oil and a third of the diesel consumed in the country.

Legal framework – chronology¹

- Article 27 of the 1917 Mexican constitution provided that property of minerals, hydrocarbons and any other materials in the subsoil belonged to the Mexican nation. Accordingly, the Federal Government was authorized to grant concessions to private parties allowing exploitation, with the particular condition of establishing regular works for their exploration.
- After 1940, when the workers, private sector and government's interests were aligned, the recognition of the exclusive property rights of the Nation over hydrocarbons together

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with the creation of a legal reserve, helped the Mexican government to take control of the decision making related to E&P.

- It wasn't until 1958, that the aforementioned legal regime was modified calling off the opportunity for private parties to conduct E&P activities, thus reserving E&P activities solely and exclusively

¹ <http://www.presidencia.gob.mx>

to the Mexican nation through Petroleos Mexicanos (PEMEX).

Proposal

- Allow oil and gas production gains through sharing contracts between Pemex and private parties.
- Participation of private parties in all midstream and downstream activities, including refining, basic petrochemicals and oil and gas (and oil and gas by-products) transportation and storage.

Regarding the aforementioned, the proposed legal reforms consist of allowing production gains through shared contracts looking forward to secure investment from the private sector, sharing gains and risks related to such activity. In this sense, drilling, processing, transport, storage and marketing of hydrocarbons could be performed either by the government or a private party. Finally, the proposed reforms will consider amendments to Pemex's tax treatment.

Expected benefits

In addition to more investment and tax resources being obtained, the reform also raises the following objectives regarding hydrocarbons:

- Achieving over 100 percent proven reserve replacement rates of oil and gas.
- Increasing oil production from the current 2.5 million barrels per day to 3 million in 2018 and 3.5 million in 2025.
- In the case of natural gas, the production will increase from the 5,700 million cubic feet per day currently produced, to 8,000 million by 2018 and to 10,400 million in 2025.

Additionally, the reform will lead to greater integration in the upstream value chain, allowing sufficient supply of gasoline, methane gas and liquefied petroleum gas at competitive prices.

Electric power

In order to transform the energy sector in Mexico, we must establish general access to electricity as a key priority of energy policy. With coverage of 98 percent, the public utility "Federal Electricity Commission" (CFE) is about to fulfill its original mission; nevertheless in recent times several issues have been



raised such as: financial deficits, rates not competitive compared to international markets and recently a higher percentage of power generation for public service was based on conventional technologies consuming fuel oil and diesel, which are four to six times more expensive than natural gas, having also a greater environmental impact.

Legal framework – chronology

- Since 1937, it has been a priority for Mexico to look forward when directing and organizing a national system of power generation, transmission and distribution based on technical and economic principles and, in order to obtain a minimum cost, the best performance possible for the benefit of general interest.
- It is important to note unlike oil and gas, electricity is not a natural resource, so the State's key interest is not the ownership of such energy, but instead finding a way to deliver energy to Mexican families at a low cost.

Proposal

- Participation of both the CFE and private parties in power generation.
- Answer a fundamental imperative to reduce the cost of electricity for the benefit of the general interest.
- Provide the basis for the organization of the "National Electricity System" based on technical and economic principles, controlled by the Mexican Government through an independent system operator, which will dispatch the generation facilities to the transmission and distribution grids.
- Strengthens the regulatory legal framework of the Mexican State to impose specific obligations to participants.

Therefore, the proposed legal reform that was submitted to the Congress provides power generation with an open market to reduce costs without the Mexican government losing control of the National Electricity System, which remains in its hands, and both the transmission and distribution grids, as an essential public service. Thus, the proposed legal reform is aimed at allowing power generation by private parties to sell energy to off-takers other than CFE.



Expected benefits

- The creation of a competitive market for capacity and energy.
- Interconnection process will increase transparency and efficiency in the provision of access to the transmission network.
- Multiple developers will be responsible for increasing capacity, making CFE able to compete and give incentives to make their own processes more efficient.

- New investment projects in the Mexican power sector, particularly clean energy projects.

In the current industry structure, the absence of a market enabling capacity and the restriction of energy being sold to customers other than the CFE, has increased the risk of investment in the sector and has focused the benefits of private participation to a few parties, which has translated into economic and financial costs that are passed on to final consumers.

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