

No, Mexico is Not Turning Into Venezuela

By Vera De Brito de Gyarfas

Following the Mexican government's latest initiative of the Mexican government to amend the Hydrocarbons Law, the concerns about Mexico following in Venezuela's footsteps to undo the energy reform (like Venezuela destroyed the 1990s oil and gas opening) are growing. It is important to keep in mind certain key differences between Venezuela and Mexico and how each country opened its oil and gas industry to private investment. This will help us understand the process that is underway in Mexico and the likelihood of the government's success in undoing the energy reform, further discussed in this article. Spoiler alert... Mexico is not Venezuela.

I. Background

President Lopez Obrador's objection to the energy reform is not new. In 2013, Lopez Obrador claimed that the Pena Nieto government had agreed on "the privatization of Mexico's oil industry" with foreign investors.¹ He held rallies against the reform and accused the government of handing out Mexico's natural resources to foreign investors, so it was no surprise that once he became president, he would object to the energy reform and try to attack it. Immediately after his election, Lopez

Obrador suspended any future bidding rounds under the Hydrocarbons Law and had all the 107 exploration and production ("E&P") contracts executed by CNH reviewed to determine their legality.² The result was that the contracts were valid and legal and Lopez Obrador has agreed to respect them.

In practice, the proposed revisions to regulations affecting the development of the E&P contracts and the administrative delays affecting the timely granting of permits are already impacting the value of these contracts and their potential implementation. The most recent attack occurred on March 25, 2021 with the initiative proposed to amend certain articles of the Hydrocarbons Law, mainly focused on the requirements to obtain midstream and downstream permits. As of April 19, the Energy and Legislative Studies Commissions of the Senate approve the proposed amendment and it is expected that the Senate will approve the amendment as proposed. Jointly with the proposed amendments to the Electricity Industry Law which have been suspended by federal courts under claims of unconstitutionality, the outlook of the potential growth of Mexico's energy reform is uncertain, to say the least.

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II. Venezuela and Mexico – Similarities and Differences

Similarly to Mexico in 2014–2018, Venezuela had an extremely successful oil and gas opening in the 1990s–2004 but unlike in Mexico, the oil and gas opening was proposed and implemented through Petróleos de Venezuela, S.A. (“PdVSA”) under PdVSA’s Expansion Plan to increase its production up to 5 million bpd in 2000.³ In the 1990s PdVSA was recognized as one of the most successful NOCs and an example of how a state-owned company could be successfully run. In 2001 Petroleum Intelligence Weekly (PIW) ranked PdVSA as the 2nd largest integrated oil firm.⁴ Unfortunately, this did not last because with the election of Hugo Chavez as President, PdVSA’s future was at risk. The oil and gas opening designed by PdVSA to increase its production and bring in IOCs to become partners and invest in different types of ventures including strategic associations, production sharing agreements and oil services contracts attracted all types of investors ranging from major international oil companies (IOCs), to smaller independent players. In a similar manner the 2014 Mexican Energy Reform attracted both foreign and domestic investors and resulted in the execution of 107 E&P contracts with foreign investors ranging from large IOCs to smaller independents including Mexican companies.

The key difference between the Venezuelan oil and gas opening and the Mexican energy reform was the legal framework. In Mexico, Articles 25, 27 and 28 of the Mexican Constitution were amended to allow private investment in the oil and gas and electricity industries. This required not only a Congressional super majority vote but also the separate ratification of the constitutional amendment by a majority of state legislatures, all of which occurred in December 2013.⁵ Additionally, secondary legislation was implemented to specifically regulate the activities that were broadly outlined in the constitutional amendments. The most relevant new legislation was the Hydrocarbons Law and the Hydrocarbons Revenue Law which regulate the participation in upstream activities in Mexico including, the types of contracts that can be executed, the authorizations required to perform specific activities, the rights and obligations of the participants, and the compensation to the State⁶. Other relevant new legislation was also

enacted to address the termination of PEMEX’s monopoly over upstream activities and its conversion into a “Productive State Company.”⁷

In Venezuela, the oil and gas opening was based on Art. 5 of the Law that Reserved to the State the Industry and Commerce of Hydrocarbons (the “Nationalization Law”), which contemplated that special association agreements could be executed with private investors subject to the approval of the National Congress; provided that they guaranteed the control by the State and had a fixed term. All requirements under Art. 5 of the Nationalization Law were fulfilled, but the legal framework was weak. In fact, in 2002, a new Organic Hydrocarbons Law was enacted, which no longer permitted private investment in oil and gas operations, and private entities were only allowed to participate as non-operators with very limited rights. Additionally, the new law did not grandfather the rights granted to investors under contracts executed between 1996 and 2002, resulting in the forced migration of such contracts to mixed company structures required under the new Organic Hydrocarbons Law, and numerous international investment arbitration claims against Venezuela for the expropriation of these projects.

The Organic Hydrocarbons Law was easily approved by the Venezuelan Congress in December 2001 (majority held by President Chavez) despite the concerns of foreign investors and the economic impact that such legislation would eventually have on Venezuela’s oil industry. The facts show that in February 2021 Venezuela produced 521,000 bpd, an amazing reduction from its all-time high of 2,995,000 bpd in October 2002.⁸ The debacle of the Venezuelan oil industry and the destruction of the Venezuelan economy as a whole is not comparable to what is occurring in Mexico, despite the similitude in ideology and attitude between Lopez Obrador and Chavez including, their focus on strengthening the NOCs, PEMEX and PdVSA, the use of the term “energy sovereignty” to prevent foreign investment in certain key areas, and the fact that their presidencies were named as the transformation of the State – the fourth transformation (*la 4ta T*) in Mexico and the fifth republic (*la 5ta República*) in Venezuela.

Another major difference is the strength of the Mexican institutions as opposed to the Venezuelan ones. Mexican Federal courts have granted

injunctions - *amparos* - against the purported amendments of the Electricity Industry Law. Several articles of the "Policy for the Reliability, Safety, Continuity and Quality of the National Electric System" ("SENER Policy")⁹ were declared invalid by the Second Chamber of the Mexican Supreme Court as a result of the Mexican Antitrust Commission's (*Comisión Federal de Competencia Económica*, "COFECE") claim that SENER overstepped its authority and undermined competition in the electricity industry by unduly strengthening CFE.¹⁰ As a result, the purported amendment of the Electricity Industry Law and the SENER Policy have been suspended.

In Venezuela, the situation was very different. As a result of the enactment of the new Constitution in 1999, Chavez appointed his supporters to most government institutions including the Supreme Court, the National Electoral Counsel, and suspended the public appointment of judges, resulting in the fact that most judges were provisional, making them subject to the control of the government who appointed them and could remove them if they did not follow the government's instructions. There was and there is no separation of powers in Venezuela. It is only in the 2015 legislative elections that the opposition was able to win back the National Assembly. In view of the foregoing, all actions of the government, including the forced migration of oil and gas projects into joint ventures operated and controlled by PdVSA were supported by all government entities and foreign investors did not even try to file claims in country. Instead, they opted to file investment arbitration claims against Venezuela before the International Centre for Settlement of Investment Disputes (ICSID)¹¹ or the United Nations Commission on International Trade Law (UNCITRAL) under the bilateral investment treaties (BITs) executed by Venezuela or against PdVSA under the international arbitration provisions of the relevant contracts. Although Chavez withdrew from ICSID in 2012 and denounced the Venezuela/Netherlands BIT, many claims were filed against Venezuela and successful awards granted in favour of foreign investors.

There are many other differences between the Mexican and Venezuelan experience which are beyond the scope of this article including the dependence of the countries on the oil and gas industry and the level of economic development of the countries.

III. Uncertain Future

At this time, the future actions of the Mexican government with respect to the Energy Reform are unclear although the goal of strengthening PEMEX is one of the government's priorities. The strength of the legal and contractual framework that supports the Energy Reform and is the basis for the investments in oil and gas exploration and production projects, energy infrastructure projects, downstream projects and the electricity industry, will make it very difficult for the government to undo the Energy Reform. That will not stop the government from continuing to undermine investments in the energy sector by raising obstacles, granting discretion to the regulatory entities for administrative procedures including the granting of permits and authorizations required to develop and implement those projects, all of which result in few, if any, new investments and the decrease in value of the existing assets.

In Venezuela, the government enacted a new law and forced the existing projects to migrate into new joint venture structures where PdVSA was the operator of every project and controlled its development. The catastrophic result of this strategy is evident today. Under the current Mexican legal framework, the government cannot simply enact a new Hydrocarbons law and force the 107 CNH contracts to be operated by PEMEX. The government would have to obtain a political consensus like the one in 2013 that would allow it to amend the Constitution and eliminate the Energy Reform. Experts state that this is unlikely to happen despite the Mexican President's intentions.¹²

These are difficult times for what could have been a booming energy opening in Mexico; however, the resources are there and the Energy Reform was designed to attract the required investors. The investors' level of funding, resilience and long term strategy will determine whether they will survive the 4T.

Endnotes

- ¹ <https://www.jornada.com.mx/2013/10/28/politica/003n1pol>
- ² <https://www.eleconomista.com.mx/empresas/AMLO-suspendera-concursos-petroleros-indefinidamente-20180903-0002.html>
- ³ See Espinasa, Ramon “El auge y colapso de Pdvsa a los treinta años de la nacionalización” , Revista Venezolana de Economía y Ciencias Sociales, v.12, n.1, Caracas, Abril 2006 - http://ve.scielo.org/scielo.php?script=sci_arttext&pid=S1315-64112006000100010
- ⁴ See Mares, David R. and Altamirano, Nelson, “Venezuela’s PDVSA and World Energy Markets: Corporate Strategies and Political Factors Determining Its Behavior and Influence”, The James A. Baker III Institute for Public Policy Rice University, March 2007 - https://www.bakerinstitute.org/media/files/page/9c4eb216/noc_pdvsa_mares_altamirano.pdf
- ⁵ https://www.wilsoncenter.org/sites/default/files/media/documents/publication/mexicos_new_energy_reform.pdf
- ⁶ Although the Energy Reform covered other activities such as power, we have focused our analysis on upstream activities.
- ⁷ Art. 1 of the Pemex Law enacted on August 11, 2014.
- ⁸ <https://www.ceicdata.com/en/indicator/venezuela/crude-oil-production>
- ⁹ “Policy for the Reliability, Safety, Continuity and Quality of the National Electric System” (Política de Confiabilidad, Seguridad, Continuidad y Calidad del Sistema Eléctrico Nacional), published on May 15, 2020.
- ¹⁰ Mayer Brown. Legal Update: Mexican Supreme Court Invalidates Sections of Ministry of Energy’s Controversial Reliability Policy. Mexico City. February 4, 2020. Available at: <https://www.mayerbrown.com/en/perspectives-events/publications/2021/02/mexican-supreme-court-invalidates-sections-of-ministry-of-energys-controversial-reliability-policy>
- ¹¹ <https://icsid.worldbank.org/cases/case-database>
- ¹² <https://www.washingtonpost.com/es/post-opinion/2021/03/23/amlo-nueva-constitucion-reformas-mexico/>

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