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The International Comparative Legal Guide to:
Gas Regulation 2009

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Mexico



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1 Overview of Natural Gas Sector

1.1 A brief outline of Mexico natural gas sector, including a general description of: natural gas reserves; natural gas production including the extent to which production is associated or non-associated natural gas; importation and exportation of natural gas, including liquefied natural gas (LNG) liquefaction and export facilities, and/or receiving and re-gasification facilities ("LNG facilities"); natural gas pipeline transportation and distribution/transmission network; natural gas storage; and commodity sales and trading.

In Mexico, only a few years ago, the activities related to the exploration, exploitation, transportation, distribution, and commercialisation of hydrocarbons and their subproducts were reserved to the State. Private investment had limited participation and faced winding schemes discouraging their interest to participate in the hydrocarbons field.

However, since the execution of the North American Free Trade Agreement ("NAFTA"), the Mexican government followed a deregulation process in the energy industry. In 1995, Mexico amended its petroleum legislation, allowing private companies to transport, store and distribute natural gas ("NG"). Private investors, including companies in which foreign investors have a controlling interest, may now (i) transport, store and distribute NG, (ii) build, operate and own NG related pipelines, installations and equipment and (iii) freely import and export NG.

To help implement these amendments, Mexico enacted the NG Regulations "*Reglamento de Gas Natural*" (the "NGR") in the fall of 1995. The NGR reflected a policy adopted by the Ministry of Energy "*Secretaria de Energia*" ("SENER") and the Energy Regulatory Commission "*Comision Reguladora de Energia*" ("CRE") aiming to the promotion of NG consumption across the country.

SENER is responsible for managing the country's energy policy by planning the short and long term energy supply through economic and social parameters. It also manages the activities of state owned enterprises in the energy sector and promotes private investment, where it is permitted. It must also ensure strict compliance with the environmental legislation and standards by performing and promoting studies in areas of interest to the energy sector and prepare and issue Official Mexican Standards ("NOM's") in its area of competence. SENER has also the authority to grant permits and authorisations for energy matters in accordance with applicable legislation relating to transportation and distribution of NG.

While SENER oversees the Mexican energy policies and plans both the short and long term energy supply, it delegates many of its

regulatory and licensing functions to CRE. Among the items determined by CRE are the prices, maximum rates, terms and conditions for NG first hand sales and transportation, storage and distribution services. Likewise, CRE grants transportation, storage and distribution permits and is responsible for applying and interpreting the NGR.

NG total reserves in Mexico (encompassing proven, probable and possible reserves) are in the order of 63,045.20 BCF. From such NG reserves, approximately 25% represents non-associated gas and the other 75% is associated gas.

Despite these NG reserves, there is a growing deficit on NG self-sufficiency. Importations of NG in Mexico have increased in recent years, whether to satisfy the supply deficit or to provide gas to the isolated pipeline systems in the northern region. The total NG demand in Mexico will have an average annual growth of 3.3% during the next 10 years, having the electricity, household, services, and vehicle transportation sectors the largest growth rate.

The Multiple Services Contracts ("MSC") and the LNG receiving terminals are recent schemes implemented by the Mexican government to mitigate the growing demand on NG. By means of the MSC, PEMEX (defined in question 2.1 below) is offering private investors, through public bid the opportunity to conduct the exploration, exploitation and development of non-associated NG basins. In addition, the LNG projects allow not only the injection of significant amounts of imported NG into the Mexican pipeline grid, but also the supply of NG to the United States. In Mexico, there are already some LNG projects in progress: Altamira (in operation), Ensenada (under construction); and Manzanillo (in bidding process). Other prospective sites under analysis are Topolobampo, Puerto Libertad and Puerto Morelos.

1.2 To what extent are Mexico energy requirements met using natural gas (including LNG)?

NG represents around 32% of the energy requirements in Mexico and has become the most important energy source. Gasolines are in the second place with 24% and then fuel oil is third with 17%. We also have electricity with 12%, diesel 9%, biomass 5% and petroleum coke 2%. Others represent the remaining 8% of the energy requirements in Mexico.

1.3 To what extent are Mexico natural gas requirements met through domestic natural gas production?

In 2006, the national consumption of NG was 6,531 MCFD. For this consumption, domestic production roughly covered 84.9%. The rest was supplied from imports that reached 988 MCFD during

that same year. NG is mostly imported from the United States. Another alternative to meet future demand is headed by the LNG regasification projects. In Altamira, the imports reached around 79 MCFD in 2006 (during its first year of operation) and is expected to finally reach 500 MCFD in 2009. Its supply comes from Nigeria (48.1%), Trinidad & Tobago (22%), Egypt (9.9%) and Qatar (19.9%). Ensenada (under construction) forecasts 1000 MCFD. Manzanillo (in bidding process), is expected to reach between 375 MCFD to 500 MCFD.

1.4 To what extent is Mexico natural gas production exported (pipeline or LNG)?

In 2006, PEMEX exported 33 MCFD of NG, which is less than 1% of the entire yearly production. These exportations were made through the pipelines of Gulf Terra, Kinder Morgan, Tetco and Tennessee, and their main destination is the United States.

2 Development of Natural Gas

2.1 Outline broadly the legal/statutory and organisational framework for the exploration and production ("development") of natural gas reserves including: principal legislation; in whom the State's mineral rights to natural gas are vested; Government authority or authorities responsible for the regulation of natural gas development; and current major initiatives or policies of the Government (if any) in relation to natural gas development.

Under the Mexican Constitution (the "Constitution"), the ownership and exploitation of petroleum and other hydrocarbons is reserved to the State, with Petroleos Mexicanos ("PEMEX") monopolising the oil and gas sectors. The Constitution also mandates that the exploration and exploitation of NG are exclusively for the Mexican State and no concessions are allowed for its development. It also provides that the public sector is exclusively responsible for the oil and hydrocarbons strategic areas and that it must maintain ownership and control of the entities responsible for such areas.

Although the development of NG remains restricted to private investment, recent amendments have opened its doors. Particularly, the adoption of new regulations and the incorporation of amendments to our legislation, such as: i) amendments to the Regulatory Law of Constitutional Article 27 in the Oil sector ("Regulatory Law"); ii) enactment and amendment of the new Foreign Investment Laws and its Regulations; iii) enactment of NGR, iv) enactment of the CRE law, and recently; v) the enactment of a new PEMEX Law which abrogates the Organic Law of PEMEX and Subsidiaries (Please see question 11.1).

PEMEX, the State owned entity created to take over petroleum assets expropriated from foreign owned companies, is within the 10 largest oil companies in the world. While the Constitution specifically reserves the ownership of sub soil resources (including minerals, petroleum and hydrocarbons) to the State, article 2 of the new PEMEX Law sets forth that PEMEX shall have the purpose of centrally conducting and strategically leading all activities encompassed within the State petroleum industry. Therefore, PEMEX enjoys exclusivity (protected by the Constitution) over the development of NG.

In 1992, PEMEX was divided into a new holding company, Petroleos Mexicanos Corporative, which remains responsible for overall strategic planning and finance within the industry, and into four additional subsidiaries: (i) PEMEX Exploration and Production ("PEP"), (ii) PEMEX Refining, (iii) PEMEX Gas and

Basic Petrochemicals ("PGPB"), and (iv) PEMEX Secondary Petrochemicals. Pursuant to the new PEMEX Law, these subsidiaries shall continue its activities meanwhile the Executive Power issues reorganisation decrees for PEMEX.

PEMEX's failure to accumulate internal funds has resulted in a desperate need for investment in oil and gas exploration, as well as for production activities. In addition, a lack of reinvestment by the public sector in the existing infrastructure has increased labour, environmental and safety issues.

PEMEX has sought to promote the participation of the private sector in NG development. With the legal monopoly of the upstream activities, PEP has created the MSCs, which aim to develop and maintain the non-associated NG fields.

The purpose of an MSC is to offer through public bid diverse development works to one single contractor. The contractual scheme of an MSC does not create, nor may it be construed as a scheme that grants a concession, production contract, profit-sharing or risk-sharing contract, or any other type of contract of similar nature. Therefore, without reference to production levels, the contractor will simply receive cash payments based upon work progress.

PEMEX launched the first MSC bidding round in 2003. The State company awarded five blocks in the Burgos Basin to international and domestic developers. In 2004, PEMEX held a second MSC bidding round for two other areas that did not receive bids during the first round. PEMEX awarded one of these blocks and no proposals were presented for the other block (PEMEX is analysing the possibility of holding a new bidding for this particular block). Recently, PEMEX finished the third round of biddings, which includes three new blocks.

Currently, the Federal Government and many leading organisations are greatly interested in creating new vehicles, schemes and reforms allowing private participation in the development of oil and NG along deep water sites, some which are expected to design an improved structure that will foster the development of the NG as well as the response to the current challenges of the sector.

2.2 How are the State's mineral rights to develop natural gas reserves transferred to investors or companies ("participants") (e.g. licence, concession, service contract, contractual rights under Production Sharing Agreement?) and what is the legal status of those rights or interests under domestic law?

Under the Constitution, all minerals must be under the domain of the State. Except for radioactive minerals, oil and gas, other minerals may be exploited by participants through concessions. However, PEMEX may enter into service agreements with participants when it may be required for the best execution of its activities. The applicable consideration to be paid to the participants for engaging into these activities shall always be in cash and under no circumstances PEMEX shall compensate them with product percentages or participation in the results of such exploitation.

Moreover, SENER has enacted a decree amending the Regulatory Law and the Mining Law, allowing the exploitation of coalbed gas. This decree provides several benefits and opportunities in favour of mining companies to utilise this gas for self-consumption or power generation. Despite the devastating effects on the environment, venting the coalbed gas was the only available alternative for miners to reduce the explosion risk inside the coal mines before this reform. For this reason, the development of infrastructure for the use and capture the coalbed gas can be partially financed with the certification of the reduction of greenhouse gases through the application of the Clean Development Mechanism of the Kyoto

Protocol. In addition, a recent amendment to the Regulatory Law provides that the coalbed gas will be subject to the same regulation that applies to NG transportation, distribution and storage. (Please see question 11.1.)

2.3 If different authorisations are issued in respect of different stages of development (e.g., exploration or production arrangements), please specify those authorisations and briefly summarise the most important (standard) terms (such as term/duration, scope of rights, expenditure obligations).

Any work related to the NG development industry requires for its execution a permit issued by SENER and is exclusively granted to PEMEX. The timeframe for SENER to issue this permit is generally 30 days, although it may be granted earlier.

2.4 To what extent, if any, does the State have an ownership interest, or seek to participate, in the development of natural gas reserves (whether as a matter of law or policy)?

In accordance with the Constitution and the Regulatory Law, the Mexican State has the sole ownership of petroleum and other hydrocarbon resources and the exclusive right for their exploration and exploitation.

2.5 How does the State derive value from natural gas development (e.g. royalty, share of production, taxes)?

As mentioned before, the developing of NG is reserved to the Mexican State and specifically entrusted to PEMEX, which is controlled by the Federal Government. PEMEX does not pay any royalties or share of production; however, in 2008 it is required to pay a 74% tax rate on the revenues generated by the sale of hydrocarbons, and its by-products.

2.6 Are there any restrictions on the export of production?

Although the exportation of NG may be performed without government authorisations or permits, the applicable foreign-trade requirements and procedures must be followed. Indigenous gas is only exported by PEMEX, given the constitutional constraints for its development.

2.7 Are there any currency exchange restrictions, or restrictions on the transfer of funds derived from production out of the jurisdiction?

In accordance with all of the investment treaties that Mexico has ratified, Mexico cannot impose any sort of exchange controls or transfer restrictions, except in those cases determined by the International Monetary Fund.

2.8 What restrictions (if any) apply to the transfer or disposal of natural gas development rights or interests?

See question 2.1.

2.9 Are participants obliged to provide any security or guarantees in relation to natural gas development?

PEMEX has direct control and exclusivity over the NG

development industry, but when PEP engages with private contractors any activity related to NG development, PEP may request these contractors different contractual guarantees, insurance policies, performance and quality bonds, among others.

2.10 Can rights to develop natural gas reserves granted to a participant be pledged for security, or booked for accounting purposes under domestic law?

See questions 2.1 and 2.2.

As explained before, PEMEX has the monopoly of the NG upstream activities, through PEP. In virtue of the MSC described above, contractors may only perform upstream activities under the supervision of PEP; however, PEMEX cannot grant to contractors a percentage of, or participation in, the production of NG.

In addition, the Constitution forbids PEMEX to grant a security interest with respect to NG reserves, except for the pledge of account receivables under certain specific circumstances.

2.11 In addition to those rights/authorisations required to explore for and produce natural gas, what other principal Government authorisations are required to develop natural gas reserves (e.g. environmental, occupational health and safety) and from whom are these authorisations to be obtained?

Besides the permit identified under question 2.3 above, other authorisations and requirements are mainly related to environmental matters. These authorisations may include the following: Environmental Impact Authorization (EIA), Zoning Authorization, Environmental Risk Evaluation, Accident Prevention Program, Consolidated Environmental License for Emissions Control, Federal Maritime Landzone, Hazardous Registry, among others.

The Ministry of the Environment and Natural Resources ("SEMARNAT") is the competent authority to issue these authorisations and approve some other applicable requirements.

2.12 Is there any legislation or framework relating to the abandonment or decommissioning of physical structures used in natural gas development? If so, what are the principal features/requirements of the legislation?

When SEMARNAT issues the EIA, it usually requires the restoration of all the damages caused by the NG development activities. Furthermore, if contamination is found at the site, the remediation activities must be conducted and reported to SEMARNAT and the Federal Bureau of Environmental Protection. Prior to the decommissioning or abandonment of the site, it will be necessary to provide a notice to SEMARNAT if the company generated hazardous wastes.

3 Importation / Exportation

3.1 Outline any regulatory requirements, or specific terms, limitations or rules applying in respect of cross-border sales or deliveries of natural gas (including LNG).

The importation and exportation of NG for either consumption or marketing purposes may be freely conducted without the need of any governmental authorisations or permits of any kind; however, the applicable foreign-trade requirements and procedures must be followed. The NGR allows any party to engage in foreign trade

pursuant to the Mexican Foreign Trade Law.

The price for imported or exported NG is neither constrained by CRE nor subject to price regulation, because both factors are determined by a competitive market. Nonetheless, importers and exporters of NG may be compelled to report to CRE issues related with their sales volume, prices, corporate information, safety, maintenance, and infrastructure capacity, among others.

Pursuant to the Import and Export Duties Law and other applicable legal provisions, the importation of NG is duty-free and must be documented with a customs declaration (“Import Manifest”). The importation of NG through a pipeline may be documented on a monthly basis. In order to import NG through a pipeline, the importer must register with the Tax Administration Service (“Customs Authority”) and it must utilise a manometer or other appropriate measuring devices to determine the volume of NG being imported. Moreover, a permit should also be secured for any pipeline crossing between Mexico and United States from the International Boundaries and Water Commission.

NG may be imported under a permanent or a temporary import customs regime, depending on its purpose or use. The temporary importation regime (used for productive export purposes) may save the value added tax and the customs processing fee rate. In order to import NG under temporary basis, the importer must secure an authorisation from the Ministry of Economy to operate as a “maquiladora” company.

4 Transportation

4.1 Outline broadly the ownership, organisational and regulatory framework in relation to transportation pipelines and associated infrastructure (such as natural gas processing and storage facilities).

PEMEX maintains an important role in NG supply given its position as the sole domestic producer. PGPB is responsible for the first-hand sales, which is the first sale of NG produced in México by PEMEX and delivered to a third party within the Mexican territory. Hence, PGPB as owner of its own transportation pipeline, is the main transportation permittee and is subject to the NGR and the authority of the CRE (as any other permittee).

In 2007, the NG transportation infrastructure was comprised of 12,353 kilometres of length. The CRE has granted 20 open access permits encompassing 11,501 kilometres and 135 self-use permits which represent 852 kilometres. PGPB’s own infrastructure is mainly constituted by the so-called National Pipeline System (SNG), which 8,704 kilometres pass throughout 18 states of the country and the Naco-Hermosillo 339 kilometres isolated pipeline interconnects with the neighbouring state of Arizona, United States.

As the cost of pipeline expansions and high tariffs weaken the feasibility of new NG transportation projects, PEMEX, SENER and CRE are working on a new model to facilitate expansions and redundancy to the transportation system. This proposal encompasses the creation of a new National Integrated System (SNI), which will include the SNG and other interconnected private systems that meet certain criteria. This model aims to implement a Roll-in tariff methodology to facilitate expansions and redundancy.

Besides the existing LNG storage infrastructure, the CRE has also granted a permit for underground storage in a salt cavern located in Veracruz known as “Caverna 204”. This permit remains subject to further verification on the feasibility of the cavern for storage of NG.

Gas processing is reserved to PGPB except for imported gas or gas already sold by PGPB. PGPB is one of the principal NG processing

companies in the world, with nearly 4,153 MCFD of NG processed during 2006 and 10 processing facilities located throughout the country.

The NGR specifically refers to transportation and storage activities: Transporters receive gas at a destination point within the transportation system and they deliver it in a similar amount at a different point through the same system. Likewise, the storage activity consists in receiving gas at a certain point on the storage system and the delivery, in one or several acts, of a similar amount at the same point or another adjacent point within the same system. Transportation and storage activities require a permit from the CRE. These permits are granted for an initial term of 30 years (subject to 15-year terms renewals) and do not confer exclusivity.

Since an end consumer requiring transportation of NG through the pipeline system may be located within or outside a geographic zone (see explanation in question 5.1 below), there are three scenarios for the development of the infrastructure needed for its transportation:

- The consumer is located within a geographic zone established by CRE (see question 5.1).
- The consumer is located outside of a geographic zone. An authorised carrier could provide transportation services to any third party.
- Transportation for self-use. A permit may be requested by an individual or entity for its exclusive use or by a “self consumption group” composed by several individuals or entities that provide NG transportation exclusively to its members. The self-use permit could be used to develop a pipeline system providing service to one or several locations where the final consumers are part of a “self consumption” group. These permittees cannot market, distribute or transport NG to third parties and they must only provide transportation and distribution services to the members of the “self consumption group” or themselves.

4.2 What Governmental authorisations (including any applicable environmental authorisations) are required to construct and operate natural gas transportation pipelines and associated infrastructure?

In addition to the permit from the CRE, the transportation infrastructure must comply with other environmental requirements. SEMARNAT will require an EIA or submittal of a Preventive Report prior to constructing a pipeline system. In those cases in which more than 500 Kg of methane gas will be transported or stored, an additional risk assessment study must be filed with SEMARNAT, as well as an accident-prevention program.

There are several other permits and/or licenses that may be required under the three different levels of government (local, state or federal) for the development of a transportation pipeline. These authorisations include, but are not limited to, the permit for the installation and/or crossing of a pipeline in a federal zone (railroad, highway, river, stream and sea beds, etc.), zoning authorisation, construction permit, and civil protection report authorisation, among others.

The CRE also issues certain “guidelines” to provide criteria and methods to which the first hand sales, transportation, storage and distribution of gas activities shall be subject to. These guidelines are the following:

DIR-GAS-001-07. Rates determination and price pass through for regulated activities in natural gas matters.

DIR-GAS-006-06. Regulated activities in NG.

DIR-GAS-005-03. Insurance for regulated activities in NG through pipelines.

DIR-GAS-004-00. First hand sale of NG.

DIR-GAS-003-96. Geographic zones for the distribution of NG.
 DIR-GAS-002-96. Accounting for the regulated activities in NG.
 DIR-GAS-001-96. Prices and tariffs for regulated activities regarding NG.

Likewise, the administrative agencies have the power to issue technical standards within their jurisdiction. Those technical standards also known as “NOMs” have a binding effect. CRE has already issued several NOMs relevant to the characteristics, operation and transportation of NG.

NOM-001-SECRE-03. Quality of NG.

NOM-002-SECRE-03. Facilities for the utilisation of NG.

NOM-003-SECRE-02. Distribution of NG through pipelines.

NOM-004-SECRE-97. LNG and vehicle facilities.

NOM-005-SECRE-97. LNG and service stations.

NOM-006-SECRE-99. NG odourisation.

NOM-007-SECRE - 99. Transportation of NG.

Project NOM-007-SECRE-2004. (Replaces NOM-007-SECRE-99).

NOM-008-SECRE-99. Cathodic protection of steel pipelines for NG.

NOM-009-SECRE-02. Supervision, detection and classification of NG leakage.

NOM-010-SECRE-02. Compressed NG for vehicle use. Minimum safety requirements for service stations.

NOM-011-SECRE-00. Compressed NG for vehicle use. Minimum safety requirements for vehicle facilities.

NOM-013-SECRE-04. Safety requirements for design, construction, operation and maintenance of LNG storage terminals.

4.3 In general, how does an entity obtain the necessary land (or other) rights to construct natural gas transportation pipelines or associated infrastructure? Do Government authorities have any powers of compulsory acquisition to facilitate land access?

Certain restrictions may be imposed either on the area where the NG pipeline (and LNG terminal) is to be built or on the land where a right of way is required to develop the gas pipelines or access roads serving the project. In addition to the pipeline crossing permits mentioned in question 4.2 above, rights of way require an arrangement with each and every one of the landowners affected by the project. Many of these steps will imply formalisation costs and procedures before a notary public and money to be paid to the landowners in consideration for the rights of way granted.

Since the right of way is an easement that depends upon each affected landowner, a governmental authority may not generally impose a mandatory order binding landowners to grant these rights of way or easements. In spite of the foregoing, the construction and layout of pipelines providing transportation and distribution services may be considered activities of public benefit and could, in certain cases, be subject to expropriation or temporary occupation. In theory, the CRE or SENER may, where required, apply for expropriations and limitations of ownership to obtain easements.

4.4 How is access to natural gas transportation pipelines and associated infrastructure organised?

The permittees shall provide users not unduly-discriminatory open access to their systems. Permittees may only deny access when there is no available capacity or when the access or interconnection is not technically feasible. Transportation permittees shall expand their systems so long as they can recover the expansion costs

through rates. If they don't expand their systems, end users may individually or collectively request an authorisation for the transportation of NG by securing a self-use permit as long as they meet certain consumption requirements. A self-use permit allows end users to create their own infrastructure for their supply of NG.

4.5 To what degree are natural gas transportation pipelines integrated or interconnected, and how is co-operation between different transportation systems established and regulated?

The permittees shall be bound to allow the interconnection of other permittees to their transportation systems, provided that there is the capacity available to render the service and the interconnection is technically viable.

PGPB, as the operator of the SNG shall afford third parties not unduly-discriminatory open access to its transportation system.

4.6 Outline any third-party access regime/rights in respect of natural gas transportation and associated infrastructure. For example, can the regulator or a new customer wishing to transport natural gas compel or require the operator/owner of a natural gas transportation pipeline or associated infrastructure to grant capacity or expand its facilities in order to accommodate the new customer? If so, how are the costs (including costs of interconnection, capacity reservation or facility expansions) allocated?

See questions 4.4 and 4.5 above.

4.7 Are parties free to agree the terms upon which natural gas is to be transported or are the terms (including costs/tariffs which may be charged) regulated?

Permittees' rates are regulated through a maximum rate mechanism. Permittees calculate initial rates and relevant adjustments in conformance with methodologies issued by the CRE. The methodologies will provide different rates for each type of customer and service, provided that these rates are not unduly discriminatory or conditioned upon the provision of other services. Rates calculated by permittees are submitted to the CRE for approval as maximum rates. However, the parties may freely agree upon different rates or terms, provided that the rates are not lower than the cost of providing the service. Permittees may adjust their initial maximum rates periodically based on the inflation and pursuant to the methodology issued by the CRE. Rates and charges for each service under a permit shall include all items and charges applicable to the service. The rate may include:

- Connection charge: Portion of the rate based on a fixed amount for connection to the system.
- Capacity charge: Portion of the rate based on capacity reserved to meet maximum demand over a defined period.
- Consumption charge: Portion of the rate based on the amount of services used.

Permittees may adjust rates periodically, pursuant to price indicators reflecting changes in the value of the goods and services related to the permittees' activities, changes in the tax system applicable to services under the permit, and an adjustment factor reflecting increased efficiency with respect to the service which shall be applied after the first five years of the permit.

The corresponding list of prices is provided under the General Conditions for the Service, a document which must be previously approved by the CRE and published through the Federal Official Gazette.

The new guideline issued by the CRE on 2007 regarding the rates determination and price pass through for regulated activities in the natural gas matters, shall be applicable to determine:

- (i) The maximum rates that shall be complied by the distribution, transportation or storage permittees of natural gas, in the provision of its services to the users.
- (ii) The updates and adjustments of the rates mentioned above.
- (iii) The indexes, references, parameters, criteria and another elements related to these rates determined by the authority.

5 Transmission / Distribution

5.1 Outline broadly the ownership, organisational and regulatory framework in relation to the natural gas transmission/distribution network.

The distribution activity encompasses supply and marketing of NG to end users through their own distribution network, which is the so-called “geographic zone”. A geographic zone is the area for which a permit for distribution of NG is granted and generally corresponds to a population centre. The first distribution permit for each geographic zone confers exclusivity for 12 years on the construction of the distribution system and on the transportation of NG in the zone. After the exclusivity term, other distribution permits could be granted for the same geographic zone and they shall not confer exclusivity. Notwithstanding the foregoing, permits for distribution do not confer exclusivity for marketing in the zone. Any user located in a geographic zone may contract with other parties for the supply of NG, in which case, the distributor must allow non-discriminatory open access to its distribution system. Thus, any interested party may directly negotiate the use of the distributor’s infrastructure depending on their capacity and payment of the transportation service’s fee. Distribution licensees are obligated to expand their systems so long as they can recover the expansion costs through rates.

Distributors may also transport NG within their authorised geographic zone. As any other transporter, the distribution permittees shall allow the interconnection of others to their systems, provided that there is capacity available to render the service and the interconnection is technically viable. Assuming that the distributor’s network does not reach the facilities of a final consumer, the consumer could take the following actions: (i) request the distributor to develop the needed infrastructure, or (ii) request individually or together with other consumers a NG transportation self-use permit as long as the consumption requirements meet certain criteria.

Since 1996, the CRE has bid 17 geographic zones. From such biddings, only 15 have been awarded. There are currently 22 distribution permits. These permits represent a new fuel supply alternative for 1.8 million users located in 166 municipalities of 18 States of the country. As of the date hereof, the CRE has demarcated 21 geographic zones along the country.

5.2 What Governmental authorisations (including any applicable environmental authorisations) are required to operate a distribution network?

The distribution activity is subject to permit by the CRE. The permit shall contain a series of restrictions and regulations applicable to the particular situation and it shall be granted for a specific distance, geographic zone, location and capacity.

The permits shall have an initial term of 30 years and they could be renewed for terms of 15 years. They are transferable to third parties

(complying with certain requirements).

Furthermore, the development of a distribution infrastructure shall also comply with most of the permits, licenses and NOMs described under questions 2.10 and 4.2 above.

5.3 How is access to the natural gas distribution network organised?

Similarly to the transportation system, users in a geographic zone may enter into gas supply contracts with any third party, in which case the distributor must allow non-discriminatory open access to its distribution system as long as these users pay the corresponding rate.

5.4 Can the regulator require a distributor to grant capacity or expand its system in order to accommodate new customers?

Distribution permittees are obligated to expand their systems so long as they can recover the expansion costs through rates. The only limitation is the capacity to transport and distribute NG through their infrastructure. If a distribution permittee with available capacity refuses service to a user or offers service unduly discriminatory, the affected party may request the CRE intervention.

5.5 What fees are charged for accessing the distribution network, and are these fees regulated?

See question 4.6 above. The price that distributors charge to end users is comprised by the sum of the acquisition price of gas and applicable transportation, storage and distribution rates. The distributors will pass through to end users any changes in the acquisition price of gas, transportation, and storage rates, according to the general conditions for the provision of such distribution services approved by the CRE. The rates are subject to annual adjustments based on inflation and certain currency exchange variables. Every five years, the permittee and the CRE undertake a global review and adjustment of the rates, which shall not be retroactive or have any retroactive compensatory features.

Because these approved charges are maximum rates, the parties may agree on lower rates, provided that such rates are not lower than the cost of providing the service.

5.6 Are there any restrictions or limitations in relation to acquiring an interest in a gas utility, or the transfer of assets forming part of the distribution network (whether directly or indirectly)?

Generally, the NGR does not restrict the acquisition of an interest in a gas utility. However, the infrastructure system pertaining to a specific permit shall not be sold without also selling the permit and vice versa (except when the permit has been revoked). Based on this principle, the transfer of the infrastructure assets serving a system shall also require a transfer of the permit, provided that the prior authorisation from the CRE has been secured and a notice to the Federal Commission of Competition (“CFC”) has been filed.

Moreover, transporters may be impeded to hold an interest in certain distribution geographic zones, since vertical integration of transportation and distribution permits whose systems are interconnected is prohibited. For service in a geographic zone, transportation and distribution permits shall not be granted or transferred to the same person who directly or indirectly holds such permits or has an interest in the entities who hold these permits.

The CRE may authorise certain exceptions to this prohibition.

6 Natural Gas Trading

- 6.1 Outline broadly the ownership, organisational and regulatory framework in relation to natural gas trading. Please include details of current major initiatives or policies of the Government or regulator (if any) relating to natural gas trading.**

Trading of NG is not regulated in Mexico and may be carried out by any person as long as there is no development of anticompetitive activities at the discretion of the CFC. Traders engaged in the purchase and sale of NG (including imported gas or gas acquired from First Hand Sales) may act as intermediaries regarding transportation, storage and distribution activities.

Furthermore, PEMEX will continue to perform trading of NG as owner and operator of its own transportation pipelines. The price for the gas sold by PEMEX is determined by the corresponding Directives issued by the CRE. Domestic gas is subject to the Houston Ship Channel price as a bench mark.

- 6.2 What range of natural gas commodities can be traded? For example, can only "bundled" products (i.e., the natural gas commodity and the distribution thereof) be traded?**

In Mexico, users may freely purchase NG from any supplier or marketer. The CRE does not grant exclusivity permits in trading of NG. For the distribution of NG, the first distribution permit confers exclusivity rights for 12 years only for the construction of the distribution system and the receipt, transmission, and delivery of gas within a geographic zone. Users in a geographic zone may enter into gas supply contracts with any party, in which case the distributor must allow non-discriminatory open access to its distribution system upon payment of the applicable rate.

Permittees offering different types of services shall separate every service without subjecting one to the other, and they shall also separate the purchase price and rates for each service offered. Permittees shall not, directly or indirectly, subsidise the rates of certain service with the income received from other service or with the marketing of NG and vice-versa.

7 Liquefied Natural Gas

- 7.1 Outline broadly the ownership, organisational and regulatory framework in relation to LNG facilities.**

Although the LNG activity is not expressly regulated, it has been encompassed within those activities related to storage and transportation. In Mexico, only regasification terminals have been constructed and there are no liquefaction plants. Please also see question 1.1.

CRE is also the agency which grants permits required for the installation of LNG terminals in Mexico and issues the technical guidelines regulating these activities.

- 7.2 What Governmental authorisations are required to construct and operate LNG facilities?**

The key permits for LNG terminals in Mexico are the NG storage permit granted by the CRE, the zoning permit issued by the local authorities, the construction license granted by the municipality and

the EIA issued by the SEMARNAT. In addition, a concession for the use of national waters and federal shoreline zone must be secured.

The CRE has also issued the Mexican Official Standard: NOM-013-SECRE-2004 (please see question 4.2 above).

- 7.3 Is there any regulation of the price or terms of service in the LNG sector?**

LNG developers may determine its rates in accordance with the corresponding methodologies issued by the CRE and may adjust their initial maximum rates periodically based on the inflation and pursuant to the methodologies issued by the CRE.

See also question 4.7 above.

8 Competition

- 8.1 Which Governmental authority or authorities are responsible for the regulation of competition aspects, or anti-competitive practices, in the natural gas sector?**

In Mexico, the CFC regulates economic efficiency, protects economic competition and free concurrence. The NGR addresses certain provisions in connection with economic competition of first hand sales, permits, public bids, transfer of NG infrastructure or assets and methodology for the calculation of NG rates.

When the CFC finds that effective competition exists, the terms, conditions and price for first-hand sales may be freely established by agreement of the parties. If there is effective competition, but the CFC thereafter finds that anticompetitive practices have arisen at the time of any first-hand sale, the CRE shall re-establish the terms and conditions to which such sales shall be subject.

Parties requesting a permit for transportation, storage, and distribution of NG before the CRE, shall also submit to CFC a copy of their permit application or their bid proposal, in order to comply with the Federal Law of Economic Competition (the "Competition Law"). CFC also participates in the bidding process of distribution permits, since the CRE withdraws those applications which are rejected by the CFC.

Upon transfer of an open access pipeline which transaction exceeds one of the thresholds established under Mexico's merger control rules, a concentration filing with the CFC will also be required.

- 8.2 To what criteria does the regulator have regard in determining whether conduct is anti-competitive?**

The criteria is based on economic issues, including the rules set by the NGR and the Competition Law. The following agreements or arrangements among competitors are considered by the Competition Law as absolute monopolistic practices:

- To fix, raise, coordinate or manipulate prices, or exchange information with the same purpose or effect.
- To restrict the supply or the acquisition of goods and services.
- To divide markets, or allocate customers or suppliers.
- To establish or manipulate bids or refrain from bidding.

In addition, depending upon whether there substantial market power and other requisites have also been met, certain practices among non-competitors could qualify as relative monopolistic practices.

8.3 What power or authority does the regulator have to preclude or take action in relation to anti-competitive practices?

CFC and CRE may impose sanctions within the scope of their jurisdiction. If CFC determines that some activities are developing anti-competitive practices, CFC may instruct (i) the correction or suppression of the concentration or monopolistic practice or (ii) the total or partial unwind of that practice which has been unduly concentrated, without prejudice of the penalty that may correspond. Usually, the penalties consist in fines or the revocation of the permit by the CRE. End users may also invoke control monopolistic practices through a claim filed before Mexico's Federal Consumer Protection Agency (PROFECO). The Federal Law for Consumer Protection determines the procedure and penalties for the violation of end users rights.

8.4 Does the regulator (or any other Government authority) have the power to approve/disapprove mergers or other changes in control over businesses in the natural gas sector, or proposed acquisitions of development assets, transportation or associated infrastructure or distribution assets? If so, what criteria and procedures are applied? How long does it typically take to obtain a decision approving or disapproving the transaction?

The Competition Law identifies which concentrations, (mergers, transfer, and control of entities, associations, stocks, capital portions, trusts entered with all kinds of economic agents) shall be notified and approved by the CFC. This classification attends to economic criteria (exceeding certain monetary thresholds).

CFC may, within 10 business days after the filing of the concentration notice order to the economic agents involved in the transaction to hold the concentration up until the CFC issues a resolution. The CFC will issue this resolution within 35 business days counted as of the date the notice was filed. If the CFC does not issue any resolution, it shall be deemed that the CFC does not have any objections to the concentration.

To begin a concentration investigation, the CFC shall consider, among other items, whether the acts to be reviewed:

- Grant the economic agents with the possibility to determine the prices or restrict the supply in the relevant market.
- Tend to unduly remove economic agents from, or impede their access to, the relevant market.
- Tend to develop monopolistic practices.

The CFC will object and sanction those concentrations which purpose or effect is to reduce, damage or block the economic competition and free concurrence regarding the same assets or services.

9 Foreign Investment and International Obligations

9.1 Are there any special requirements or limitations on acquisitions of interests in the natural gas sector (whether development, transportation or associated infrastructure, distribution or other) by foreign companies?

There are no restrictions to foreign investment in the NG sector, except when the investment represents more than 49% of the capital of the Mexican company and this company exceeds US \$187 million in assets. Under this scenario, an approval from the National Foreign Investment Commission shall be required, besides the authorisations from CRE and CFC mentioned above.

9.2 To what extent is regulatory policy in respect of the natural gas sector influenced or affected by international treaties or other multinational arrangements?

Mexico has signed and ratified several free trade agreements which many of them refer to relevant aspects of the energy sector.

Mexico, as a member of the Organization for Economic Cooperation and Development and participant of the International Energy Agency, must adequate all of the resolutions adopted by such organisations to its domestic legislation, as long as they do not contravene Mexican Laws.

During the negotiation of NAFTA, U.S. and Canada accepted that Mexico's energy sector was a sensitive area not to be easily open. Although under Chapter 6 and Annex 602.3 of NAFTA, Mexico reserved to itself the exclusive control over a wide range of activities in its energy sector (including exploration, exploitation, refinement, processing; foreign trade, transportation, storage and distribution of crude oil and NG), it has permitted private participation in some of these areas, but only in accordance with the policies, terms and conditions that the applicable laws and regulations may determine.

10 Dispute Resolution

10.1 Provide a brief overview of compulsory dispute resolution procedures (statutory or otherwise) applying to the natural gas sector (if any), including procedures applying in the context of disputes between the applicable Government authority/regulator and: participants in relation to natural gas development; transportation pipeline and associated infrastructure owners or users in relation to the transportation, processing or storage of natural gas; and distribution network owners or users in relation to the distribution/transmission of natural gas.

The CRE Law provides that, without prejudice to other legal actions that may apply, the disputes arising from any of the regulated activities, may be settled either through the procedure that the parties have agreed or by the procedure that the CRE determines.

The dispute resolution procedure proposed by the parties and the competent organ appointed by the parties to settle the dispute shall be registered in the Public Registry of the CRE. If no registration is made, the parties shall observe the Mexican Commercial Code provisions that apply to dispute resolutions.

End users meeting with the "consumer" criteria in terms of the Federal Law on Consumer Protection, may seek for relief under such law.

10.2 Is Mexico a signatory to, and has it duly ratified into domestic legislation: the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards; and/or the Convention on the Settlement of Investment Disputes between States and Nationals of Other States ("ICSID")?

Mexico ratified the New York Convention that regulates the recognition and enforcement of arbitral awards rendered in other territory different to the state requesting recognition and enforcement of the award.

Although Mexico is not member of the ICSID Convention, article 1120 of NAFTA refers to the ICSID as the competent organ through which NAFTA investment disputes shall be settled.

10.3 Is there any special difficulty (whether as a matter of law or practice) in litigating, or seeking to enforce judgments or awards, against Government authorities or State organs (including any immunity)?

The judgments or awards may be enforced either in accordance with the rules of the New York Convention or pursuant to the rules provided under the Mexican Commercial Code, which provides that an award, irrespective of the country where it was issued, will be recognised as mandatory and will be enforced after the submission of a written request before the competent Court. The fact that one of the parties is an authority or state entity does not abate the possibility to obtain a successful award. This is due to many reasons, for instance, sovereign immunity cannot be invoked in Mexico.

10.4 Have there been instances in the natural gas sector when foreign corporations have successfully obtained judgments or awards against Government authorities or State organs pursuant to litigation before domestic courts?

Yes, in many instances.

11 Updates

11.1 Please provide, in no more than 300 words, a summary of any new cases, trends and developments in Gas Regulation Law in Mexico.

On October 28th, 2008, the Mexican Congress approved several amendments to Mexican laws, all related to the energy sector. The main amendments regarding the NG framework are:

Two law decrees:

- I. **PEMEX Law:** This new law substitutes the PEMEX Organic Law. Its main purpose is to regulate the organisation, operation, control and accountability of PEMEX, expanding its autonomy to execute contracts, as well as its organisational and operative flexibility.
- II. **Law of the National Hydrocarbons Commission:** Creates the National Hydrocarbons Commission, which shall regulate and supervise the exploration and production of hydrocarbons, as well as the process, transportation and storage activities related with projects of exploration and production of the same.

Three amendments of law decrees:

- I. **Amendment to the Law of the Energy Regulatory Commission (“CRE”):** This amendment expands the regulatory authority of the CRE, establishing within its scope and purpose, the promotion of efficient mechanisms for the sale of gas, oil fuels, and basic petrochemicals, as well as the transportation and distribution of oil products, petrochemicals and biofuels through pipelines.
- II. **Amendment to the Regulatory Law of Constitutional Article 27 relating to Oil Matters:** Provides that the coalbed gas will be subject to the same regulation that applies to NG transportation, distribution and storage.
- III. **Amendment to article 33 of the Federal Public Administration Organic Law:** Expands the capacity of the Ministry of Energy, allowing it, among other things, to promote the private participation in the activities of the sector, as well as to grant, refuse, modify and, if applicable, to cancel the allocations for the exploration and exploitation of hydrocarbons.

The amendments herein described provide certain investment opportunities related to the transportation, storage and distribution of coalbed gas, as well as the exploitation of cross-border oilfields under the terms of international treaties entered into by Mexico. In addition, a new contractual scheme is implemented to allow PEMEX to execute contracts related to its material productive activities, whereby the PEMEX Law, its regulations and the provisions to be issued by the Board will establish the guidelines regulating said scheme. Moreover, these amendments also include compensations for those contractors engaged with PEMEX under work and services contracts and such contractors are not restrained to assist PEMEX in the activities of exploration and production of hydrocarbons (included but not limited to deep waters).

*Note: Updated information related to the NG market should be amended by the NG Prospective Market 2008-2017, that will be soon released by SENER after the completion of this chapter.

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